Asset Management Update

Consultation on concessional taxation of carried interest for private equity funds

Summary

The Financial Services and Treasury Bureau (FSTB) released its consultation on a proposed concessional tax treatment for carried interest for private equity funds.

The consultation outlines a concessionary framework for carried interest from private equity transactions that involves validation by the HKMA. However, the consultation does not specify a likely concessionary tax rate. The proposal to include the involvement of the HKMA for the concession is groundbreaking and a welcomed change of approach, which should serve the industry well in attracting talent and private equity funds to Hong Kong.

In a long awaited initiative by the Government, on 7 August 2020, the FSTB released its consultation document on the Proposal to Provide Tax Concession for Carried Interest to seek views on its proposed framework by 4 September 2020.

For the private equity industry, there has been a great deal of uncertainty on the taxation of carried interest and we have been lobbying extensively for several years on the need for an exemption or at least clarity on treatment. The private equity industry is a key component of the financial services sector in Hong Kong and plays an important role in facilitating capital flows into and out of China.

The consultation outlines at a high level a proposed framework and simply refers to a "highly competitive" concessional rate of tax to apply on carried interest arising from the provision of investment management services in Hong Kong.

In brief, the framework applies to carried interest paid by funds that fall within the meaning of "fund" in the UFE. Further, the concessional tax treatment of carry may need to be validated by the HKMA and an authorised local representative must be appointed to provide necessary particulars and information to the HKMA and Inland Revenue Department (IRD) on behalf of the fund, including particulars of persons receiving carried interest distributions.

Only carried interest paid out of profits derived from tax-exempted qualifying transactions in shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a private company will be subject to the concession - subject to the requirement that substantially all of the fund's investments have been repaid to LPs and that LPs have received an IRR of at least 6%.

By limiting the types of transactions eligible for concession, it is clear that the policy is intended to be limited to profits arising from transactions by private equity funds. Carry paid out of profits derived from transactions typically undertaken by other alternative funds trading in public securities may therefore fall outside of the concessionary treatment.

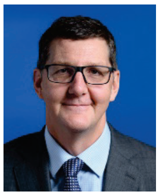
The consultation also refers to some substantive conditions. To attract talent and substantive operations to Hong Kong, the consultation proposes at least two investment professionals (1 legal and 1 compliance or finance) in Hong Kong and a minimum HK$3 million of expenditure must be incurred in Hong Kong (presumably at the fund manager level).

The requirement that the fund be validated by the HKMA is an interesting development to tax policy in Hong Kong and may give comfort to the industry that the concession will be granted to private equity funds which have operations established in Hong Kong.

We shall be in touch with our clients to discuss further and will be formalising a response to the consultation.

Contact us

Bonn Liu
Partner, Head of Financial Services, Hong Kong;
Head of Asset Management, ASPAC
KPMG China
+852 2826 7241
bonn.liu@kpmg.com



Darren Bowdern
Head of Financial Services Tax, Hong Kong
KPMG China
+852 2826 7166
darren.bowdern@kpmg.com

Vivian Chui
Partner, Head of Securities & Asset Management,
Hong Kong
KPMG China
+852 2978 8128
vivian.chui@kpmg.com

Neil Macdonald
Director, Wealth and Asset Management
Centre of Excellence Leader
KPMG China
+852 2143 8781
neil.macdonald@kpmg.com

Nigel Hobler
Partner, Tax
KPMG China
+852 2978 8266
nigel.hobler@kpmg.com

Sandy Fung
Partner, Tax
KPMG China
+852 2143 8821
sandy.fung@kpmg.com

Simmy Ko
Partner, Audit
KPMG China
+852 2143 8697
simmy.ko@kpmg.com

Arion Yiu
Partner, Audit
KPMG China
+852 2143 8599
arion.yiu@kpmg.com

Kenneth Hui
Partner, Audit
KPMG China
+852 2978 8986
kenneth.hui@kpmg.com

Kasheen Grewal
Director
KPMG China
+852 3927 4661
kasheen.grewal@kpmg.com

Anthony Pak
Director
KPMG China
+852 2847 5088
anthony.pak@kpmg.com

kpmg.com/cn