KPMG

ASSET MANAGEMENT TAX UPDATE

May 2021

Carried interest tax concession in Hong Kong to become law

Summary

The Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021 (the “Bill”) passed its third reading in the Legislative Council, unamended, late last week. Once the Bill is gazetted it will formally become law.

The passage of the Bill is the culmination of an extensive consultation process between the Hong Kong Monetary Authority (“HKMA”) and the asset management industry, and reflects the importance of the industry, and in particular private equity funds, to the economic growth in Hong Kong. Importantly, this tax incentive should further cement Hong Kong’s position as Asia’s leading private equity hub.

Carried Interest Concession

Our Asset Management Tax Update of 29 January 2021 provided an overview of the Carried Interest Tax Concession Bill.

The concessional tax treatment for carried interest is now effective from 1 April 2020, and will provide for a 0% tax rate for qualifying carried interest.

Qualifying carried interest broadly includes carried interest received from gains from investments in private companies. With some expectation, a gain on an investment in a public company or from any other non-private company investment should not qualify. The concession will therefore be restricted to PE type investments only.

The concession involves a number of conditions that need to be satisfied in order for the carried interest to qualify for the concession. These include being a qualified recipient, the need to comply with headcount and operating expenditure substance requirements, as well as the need for the fund be certified by the HKMA and the Inland Revenue Department (IRD).

Application procedures

The new concession applies to carried interest received or accrued from 1 April 2020. As such, private equity funds should now be considering whether they should be applying for the concessionary treatment for any payment of carried interest after that date.

Guidance on the application procedures have been released by the HKMA setting out how a fund may seek to become certified with the HKMA. In the draft guidance that has been made available for comment, the application process may involve an application to the HKMA and an application for assessment to the IRD to confirm that the fund qualifies as a fund for the purposes of section 20AM. As at the date of this Alert, the details of what information the IRD will require have not yet been provided.

The certification of the fund will need to demonstrate that it will invest in private equity type investments, and that it will have a sufficient level of domestic staffing and expenditure.

Also, specific details of the qualifying investments made by the Fund may also be required. This perhaps involves a level of detail that was not anticipated by the industry and it has questioned the need for such specific and detailed investment related information to be provided by the Fund.

The application procedures may differ slightly depending on whether the application is made upfront or in the year in which the carried interest is earned. However, essentially the same level of information will be required.

Ongoing requirements to avail of the concession may also require further approval requests to the HKMA in the year carry distributions are made, together with an external auditor's report, that the criteria for certification still apply.

The criteria in the auditor's report are yet to be issued by the Hong Kong Institute of Certified Practicing accountants, although the HKMA has clarified that the focus of the report will be on whether distributions have been paid out of eligible investments, and whether domestic substance requirements on employment and expenditure have been met.

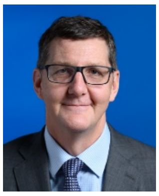
Additionally, it is proposed that a responsible officer will be required to notify the HKMA within 30 days of the fund no longer complying with the criteria for certification.

Going forward

Overall, the concessional tax treatment for carried interest distributions on carried interest should be welcomed by the industry. Whilst acknowledging the HKMA's need for a base level of information to satisfy itself that the fund will operate as intended under the concession, it is hoped that the level of detail required is not excessive as this may cause many existing offshore funds to question whether it will be worth providing such information – particularly given that the IRD may have a greater involvement in the certification process that previously envisaged. Earlier consultation documents indicated that the HKMA would administer the concession and that the IRD would only consult with the HKMA to consider if investment management services are eligible.

If the HKMA can strike the right balance with satisfying itself that the concession will not be abused, and encouraging the fund management industry to get on with utilizing the various tax concessions, Hong Kong should continue as the leading jurisdiction for offshore funds to establish their regional platforms.

Contact us



Darren Bowdern
Head of Alternative Investments, Hong Kong
Head of Asset Management Tax, ASPAC
KPMG China
Tel: +852 2826 7166
darren.bowdern@kpmg.com

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

Sandy Fung
Partner
KPMG China
Tel: +852 2143 8821
sandy.fung@kpmg.com

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

Nigel Hobler
Partner
KPMG China
Tel: +852 2978 8266
nigel.hobler@kpmg.com

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

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