Offshore Private Equity Funds to qualify for exemption

The 2013-14 Budget set in motion two important developments for the funds industry in Hong Kong. For the Private Equity (PE) industry, the Government announced its intention to amend the current offshore fund exemption to PE Funds so that they qualify for the same tax exemption as other offshore funds. To the broader funds sector, the Government will also review the legal, tax and regulatory framework to allow Open-ended Investment Companies to be domiciled in Hong Kong.

The proposal announced in respect of the offshore fund exemption is an important development for the PE industry. For years, the Hong Kong PE Funds environment has been at a competitive disadvantage to other fund centres as there has been no specific exemption that clearly applied to offshore PE Funds operating through Hong Kong. Although Hong Kong has an offshore fund exemption regime, that exemption applies principally to offshore hedge funds and not to PE Funds. As a result, PE Funds have had to structure their operations outside of Hong Kong so that they would not expose the Fund to Hong Kong tax.

KPMG had been actively lobbying the Government to introduce an exemption and the proposal announced by the Government in its Budget was met with enthusiasm from the industry.

At this stage, the Government has only indicated that the offshore fund exemption is to be extended to cover PE Funds. Although no specific details have been given on how the Government intends to apply the offshore fund exemption to PE Funds, we anticipate that this will be affected by including private companies within the range of permitted investments. The current tax exemption for offshore funds exempts non-resident persons (including individuals, corporations, partnerships and trustees of trust estates) from tax in respect of profits derived from certain specified transactions carried out through or arranged by specified persons (with restrictions on what activities may be carried out in Hong Kong).

Under the existing rules, an investment in a "private" company would not be caught by the exemption, and as such, PE Funds have not been able to qualify. It is therefore anticipated that the proposal will address these particular issues, but it may be that only offshore incorporated companies will be permitted investments. The Government announced that there may be an exclusion for companies that hold property in Hong Kong and offshore companies that carry on business in Hong Kong.

The formal introduction of the above proposals may still be some time away. The Government will undertake extensive consultations prior to issuing the draft bill. There remains many important details to be sorted out during the consultation process, for example, whether Hong Kong companies that are not 'land rich', will be covered by the exemption and in addition, the implications for Hong Kong special purpose vehicles holding China PE investments. KPMG will be part of this ongoing process to ensure that the interests of the industry are appropriately addressed. The extension of the offshore funds exemption to PE Funds will provide far greater flexibility to Hong Kong based PE Fund professionals, allowing them to focus on the main job of successfully investing investor's money rather than worrying about triggering an unintended tax cost for their investors through their actions in Hong Kong.

KPMG
cutting through complexity

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