

HONG KONG TAX ALERT

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Offshore funds exemption changes

The Inland Revenue (Amendment) Bill 2015 was approved by the Hong Kong Legislative Council on 13 July 2015 and is expected to be gazetted on either 17 July 2015 or 24 July 2015, following which the legislation changes will take effect. The Bill extends the profits tax exemption for offshore funds to private equity funds.

Summary

- *The new legislation will extend the profits tax exemption for offshore funds to private equity funds*
- *The legislation introduces three key changes:*
 1. *Extending the profits tax exemption to offshore PE funds by expanding it to cover investments in private companies incorporated offshore*
 2. *Extending the tax exemption to special purpose vehicles which are established to hold offshore investments*
 3. *Waiving the current requirement for investments to be arranged by SFC licensed persons*

The enactment of the new legislation will extend the existing offshore funds tax exemption to private equity (PE) funds.

The legislation changes have been long anticipated and will be welcomed by the Hong Kong PE industry. The key features of the new legislation include:

- Extending the scope of transactions covered by the exemption to include investments in private companies incorporated outside of Hong Kong. This is naturally a key feature of a PE fund's business so this is a very important change
- Exempting special purpose vehicles (SPVs), including Hong Kong SPVs, from Hong Kong profits tax on gains on disposal of a qualifying offshore portfolio company (this also includes gains by one SPV from the disposal of another SPV which holds a qualifying offshore portfolio company)
- Loosening an existing requirement that qualifying transactions be arranged through a person with a Securities and Futures Commission (SFC) license in order to rely on the exemption. For offshore PE funds, the SFC license requirement has been removed where the fund has at least five investors at its final close which have collectively committed more than 90 percent of the capital of the fund

The content of the enacted legislation is consistent with the draft legislation previously proposed by the Hong Kong Government. Please refer to [our earlier Tax Alert](#), which discussed the changes in more detail.

The newly enacted ordinance will take effect after it has been signed by the Chief Executive and published in the Gazette.

How can KPMG help?

The amended ordinance provides scope for PE funds operating in Hong Kong to benefit from the offshore funds exemption. However, in some cases it may be necessary for funds to implement some operational changes to ensure that they fall within the scope of the exemption.

In addition, there should be opportunities to amend existing operating procedures to make life easier for deal teams based in Hong Kong. Some of the issues which can be considered include:

- Whether changes should be made to existing operating protocols to allow more investment related decision making, board meetings and management oversight to take place in Hong Kong
- Ascertaining whether all types of investments contemplated under a fund's existing mandate would be covered by the revised exemption, and if not, determining what needs to be done to mitigate the risk of non-qualifying investments tainting income generated from other investments
- Whether to establish a Hong Kong platform for holding investments in order to benefit from Hong Kong's rapidly expanding tax treaty network
- What level of substance can or should be established in the investment holding SPVs having regard to both the scope of the revised exemption and also what is needed in the investee jurisdiction in order to qualify for treaty benefits
- Assessing the impact of any changes made on existing transfer pricing arrangements to support advisory fees paid to Hong Kong investment advisors
- Confirming whether the PE fund will satisfy the new alternative to having qualifying transactions arranged through a SFC licensed person

KPMG has a dedicated team of tax professionals, focussed on servicing PE clients, who have been actively involved in the government consultation process and have extensive experience in assisting clients to establish offshore PE fund structures. Our team would be pleased to meet with you to discuss the impact of the changes on your business.

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