

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.

Contact us:

Khoon Ming Ho
Partner in Charge, Tax
China and Hong Kong SAR
Tel: +86 10 8508 7082
khoonming.ho@kpmg.com

Ayesha M. Lau
Partner in Charge, Tax
Hong Kong SAR
Tel: +852 2826 7165
ayasha.lau@kpmg.com

Corporate Tax

Charles Kinsley
Principal
Tel: +852 2826 8070
charles.kinsley@kpmg.com

Chris Abbiss
Partner
Tel: +852 2826 7226
chris.abbiss@kpmg.com

Stanley Ho
Principal
Tel: +852 2826 7296
stanley.ho@kpmg.com

Alice Leung
Partner
Tel: +852 2143 8711
alice.leung@kpmg.com

Curtis Ng
Partner
Tel: +852 2143 8709
curtis.ng@kpmg.com

John Timpany
Partner
Tel: +852 2143 8790
john.timpany@kpmg.com

Matthew Fenwick
Director
Tel: +852 2143 8761
matthew.fenwick@kpmg.com

Ivor Morris
Director
Tel: +852 2847 5092
ivor.morris@kpmg.com

Michael Olesnick
Special Advisor
Tel: +852 2913 2980
michael.olesnick@kpmg.com

Justin Pearce
Senior Tax Advisor
Tel: +852 2143 8756
justin.pearce@kpmg.com

M & A Tax

Darren Bowdern
Partner
Tel: +852 2826 7166
darren.bowdern@kpmg.com

Benjamin Pong
Principal
Tel: +852 2143 8525
benjamin.pong@kpmg.com

Christopher Xing
Partner
Tel: +852 2978 8965
christopher.xing@kpmg.com

Yvette Chan
Director
Tel: +852 2847 5108
yvette.chan@kpmg.com

Malcolm Prebble
Director
Tel: +852 2685 7472
malcolm.prebble@kpmg.com

China Tax

Daniel Hui
Principal
Tel: +852 2685 7815
daniel.hui@kpmg.com

Karmen Yeung
Partner
Tel: +852 2143 8753
karmen.yeung@kpmg.com

Adam Zhong
Principal
Tel: +852 2685 7559
adam.zhong@kpmg.com

Steve Man
Director
Tel: +852 2978 8976
steve.man@kpmg.com

Transfer Pricing

John Kondos
Partner
Tel: +852 2685 7457
john.kondos@kpmg.com

Kari Pahlman
Principal
Tel: +852 2143 8777
kari.pahlman@kpmg.com

International Executive Services

Barbara Forrest
Principal
Tel: +852 2978 8941
barbara.forrest@kpmg.com

Murray Sarelius
Partner
Tel: +852 3927 5671
murray.sarelius@kpmg.com

David Siew
Partner
Tel: +852 2143 8785
david.siew@kpmg.com

Kate Lai
Director
Tel: +852 2978 8942
kate.lai@kpmg.com

US Tax

Wade Wagatsuma
Partner
Tel: +852 2685 7806
wade.wagatsuma@kpmg.com

Indirect Tax

Lachlan Wolfers
Partner
Tel: +852 2685 7791
lachlan.wolfers@kpmg.com

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