



Hong Kong Limited Partnership Fund (“HKLPF”)

Tax Kit for LPF Structure under Different Investments

Loyalty Link Us

Features of LPF

Confidentiality protection

No min. capital requirement / investment restriction

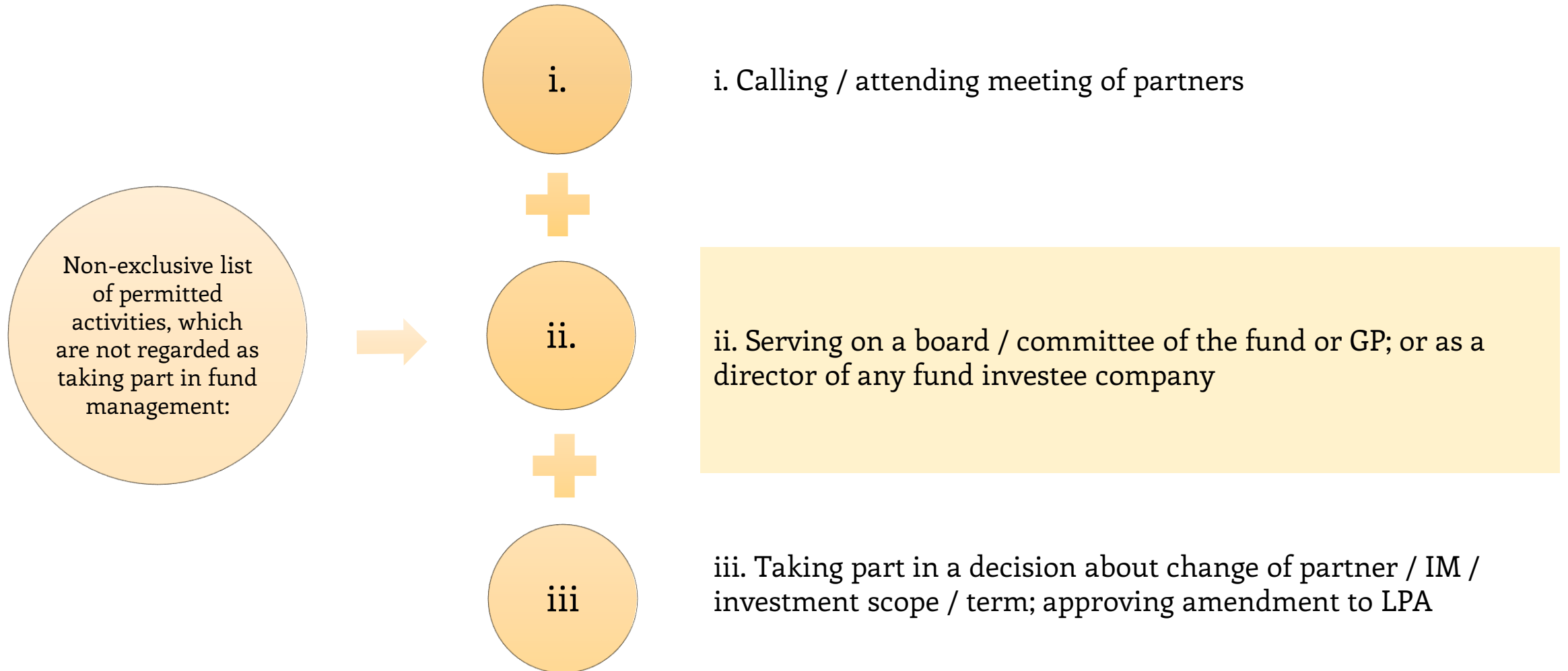
Not require SFC authorization*

Safe harbour to protect LPs' limited liability

Full freedom to conclude contracts

*unless it is publicly offered to retail investors

Comprehensive safe-harbour protection of investors' limited liability



Extensive freedom of contract

Covers, without limitation:

Investment scope

Admission and withdrawal of partners

Powers, rights and obligations of partners

Capital contributions and withdrawal,
distribution of proceeds, and clawback
obligations

Frequency of financial reporting

Custodial arrangement

Life of the fund

Fund dissolution procedures

LPF vis-a-vis typical offshore fund vehicles (1)

	LPF	Typical offshore LP vehicle
Regulatory approval	Not required	Not required
Minimum capital requirement	No	No
Restriction on investment scope	No	No
Freedom of contract	Yes (Very Broad)	Yes
Prescribed LP safe harbour activities	Yes (Very Broad)	Yes
Public access to LP information	No	No
Separate legal personality	No	No

LPF vis-a-vis typical offshore fund vehicles (2)

	LPF	Typical offshore LP vehicle
Registration fee	US\$390 (HK\$3,034)	>US\$4,000
Annual return filing fee	US\$13 (HK\$105)	>US\$1,000
Custodian	Not mandatory	Mandatory custodian appointment
Audit	Local (HK) auditors appointment	Local auditors appointment
Accounting standards	No specified requirements	IFRS or GAAP in non-high risk jurisdictions



LPF is less costly and burdensome to set up and maintain

Hong Kong as Asia's leading Private Equity hub

What's driving the trend for the development of HK as an international asset and wealth management center

- Robust growth in wealth creation in Asia
- Increase in portfolio allocation to the Asian markets
- Deepening financial market liberalization in Mainland China

HK Government has stepped up the effort to diversify the fund structures to encourage fund formation in HK

PE industry channeling capital into corporates in the Greater Bay Area. As at 2019, the total capital under management by 560 PE firms operating in HK reached about USD160 billion*

What's driving the trend for 'onshoring' – global developments, economic substance requirements, investor demand and new private fund registration requirements ?

Hong Kong as Asia's leading Private Equity hub

HK Government is promoting the AM sector to attract managers

- Non-resident Person Exemption (Section 20AC of Inland Revenue Ordinance (IRO) in 2015
- Open-ended fund company (“OFC”) in 2018
- Unified Fund Exemption (“UFE”) regime (Section 20AN of the IRO) in 2019
- Limited Partnership Fund (“LPF”) in 2020
- Proposed Carried Interest Concession in 2020

Key elements in the LPF regime

Align the fund with where the management substance is located, especially in light of the OECD's BEPS Action Plan

Sufficient substance to get HK TRC ? The Fund may be able to enjoy HK's extensive double tax treaty network

As good as other traditional funds

Business-friendly

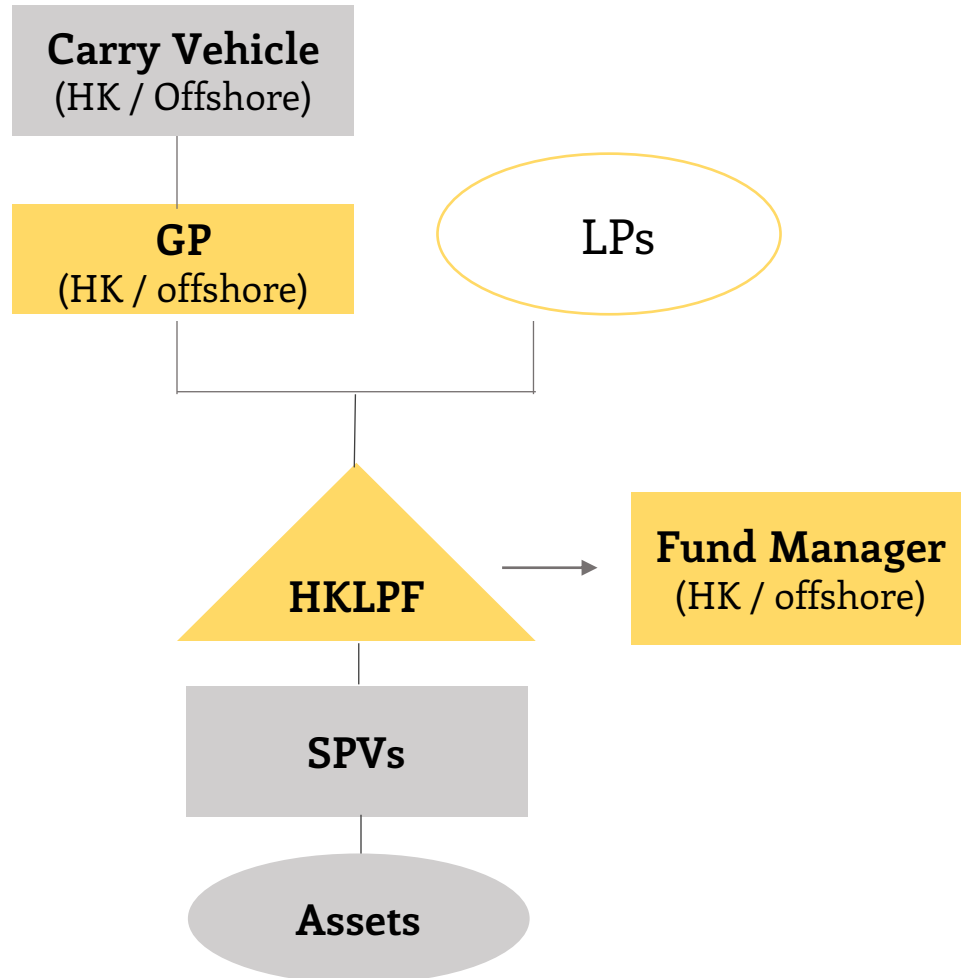
Low set up, maintenance & compliance costs

Tax exemption at Fund and SPV level

Clarity around taxation of carried interest

Clarity around taxation of management fees between HK and offshore

LPF – Basic structure



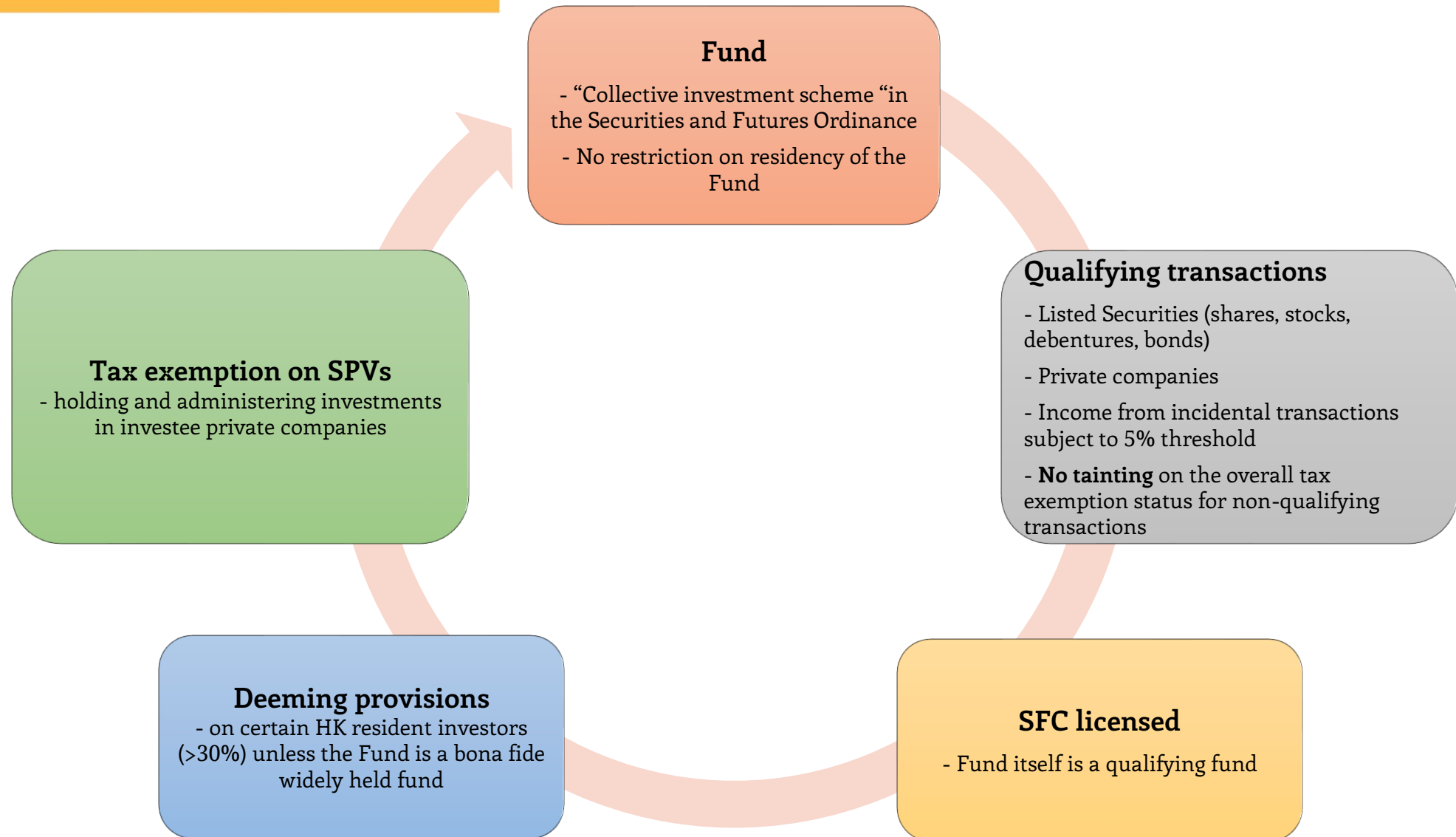
Key features

- Constituted by Limited Partnership Agreement
- Registered with the Registrar of Companies as an LPF
- With one GP and at least one LP (2 years grace period to raise third party capital otherwise risk of being strike off)
- Must appoint an Investment Manager, or the GP itself carries out the day-to-day investment management functions
- GP needs to be HK resident
- Has a registered office in HK

Tax

- An LPF will be exempt from HK Profits Tax if the Unified Fund Exemption (“UFE”) regime applies
- No HK stamp duty on issuance / transfer / withdrawal of LPF interests
- HK tax filing obligation ?
- Annual audit requirement

Key framework of the Funds Exemption



SPV Exemption under UFE

SPV exemption covers both HK and offshore SPVs

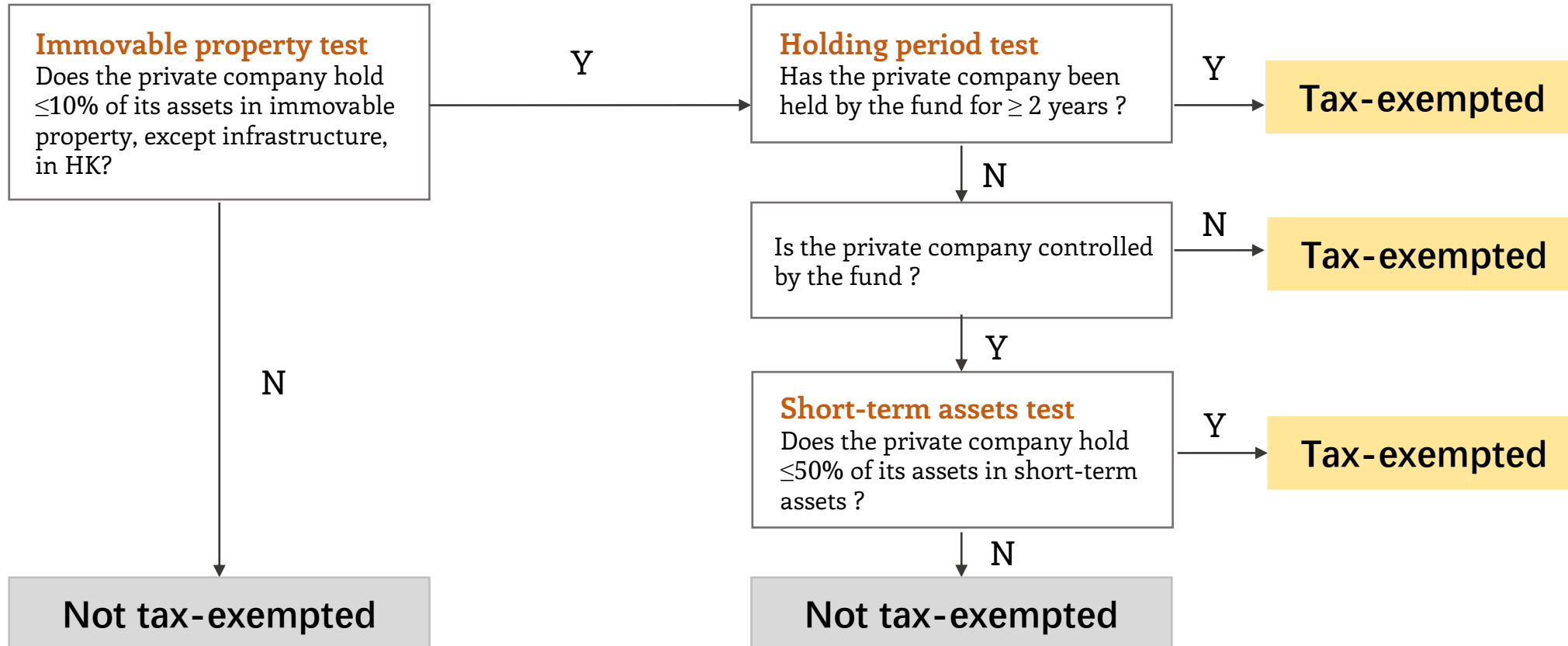
The SPV must be established solely for the purpose of **holding** and **administering** investments in investee private companies (either HK or non-HK incorporated)

The SPV Exemption doesn't cover investments in non-private companies with some exceptions in practice. Qualifying transaction at the Fund level is broader than at the SPV level

DIPN 61 para 101:

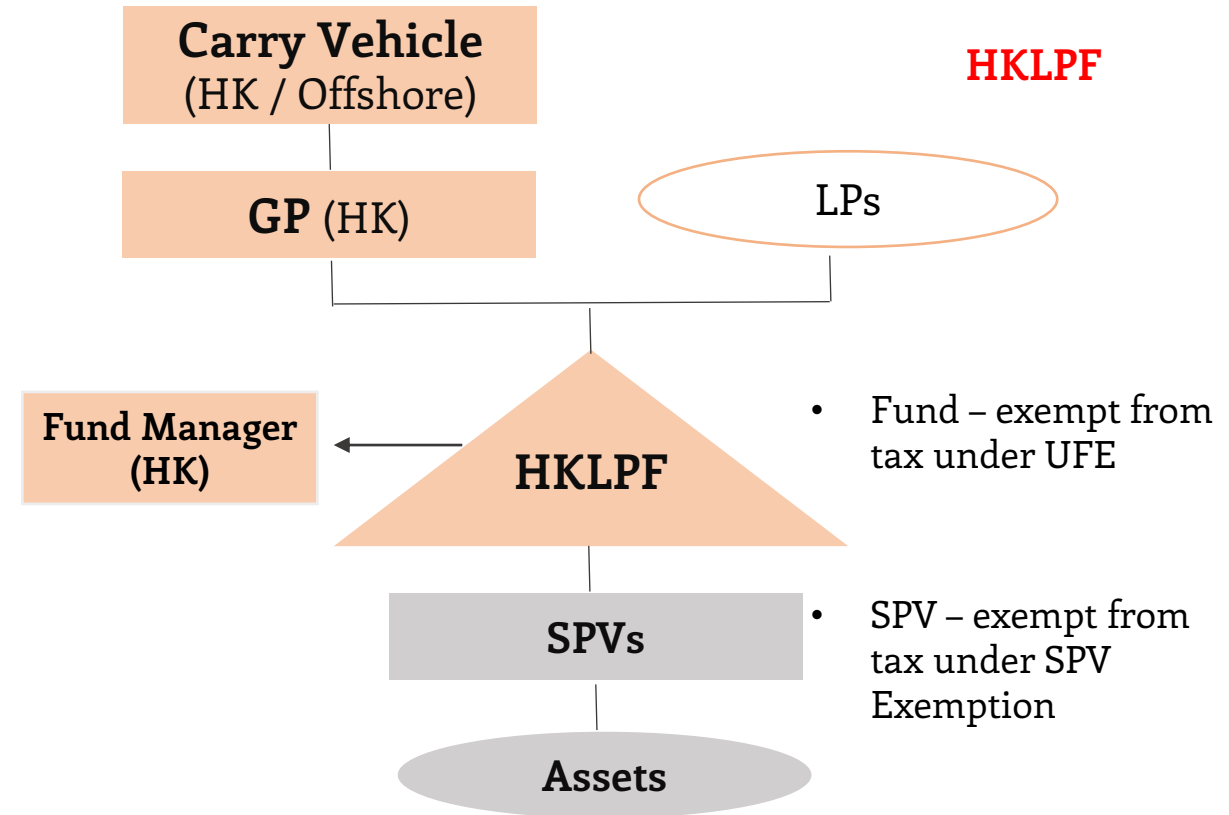
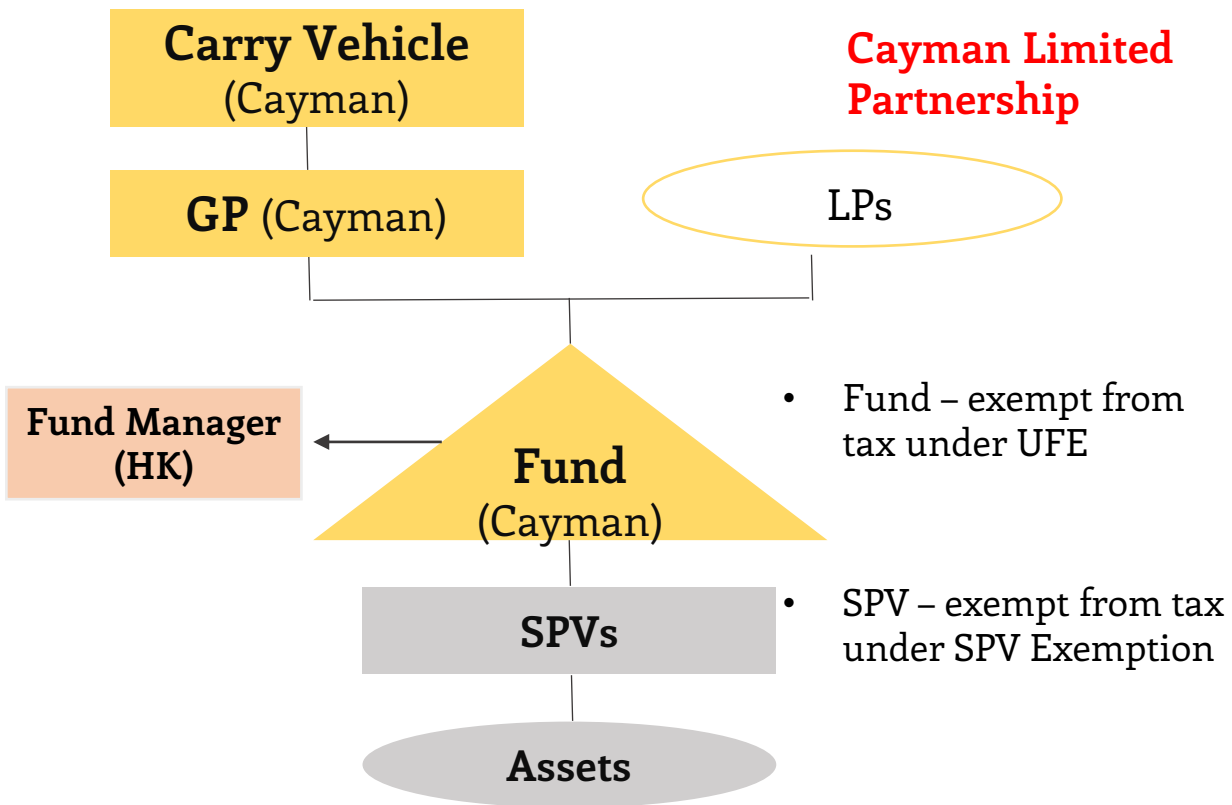
- The activities of SPV are restricted to the review of financial statements of investee private companies, attending the shareholders' meetings, opening bank accounts for collection of dividends, appointing company secretary
- “If the obligations undertaken by a SPV **far exceeds** those normally attached to a shareholder, the SPV would not satisfy the exemption.”

SPV Exemption – Test on investment in private company

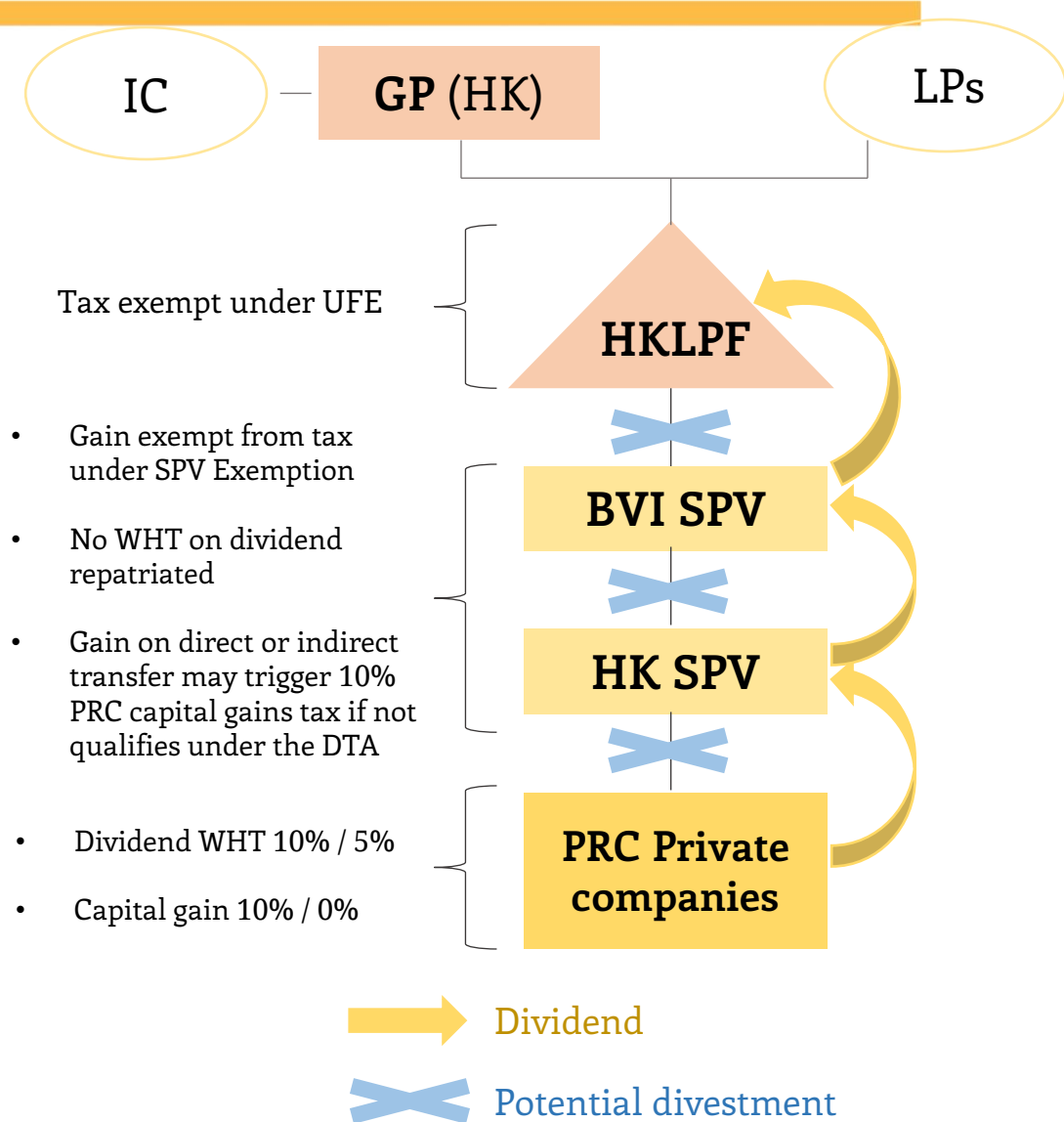


LPF – contrast with traditional Cayman fund structure

Identical structures for LPF and Cayman fund



LPF structure for a China PE investment



LPF

- Exempt from HKPT under UFE

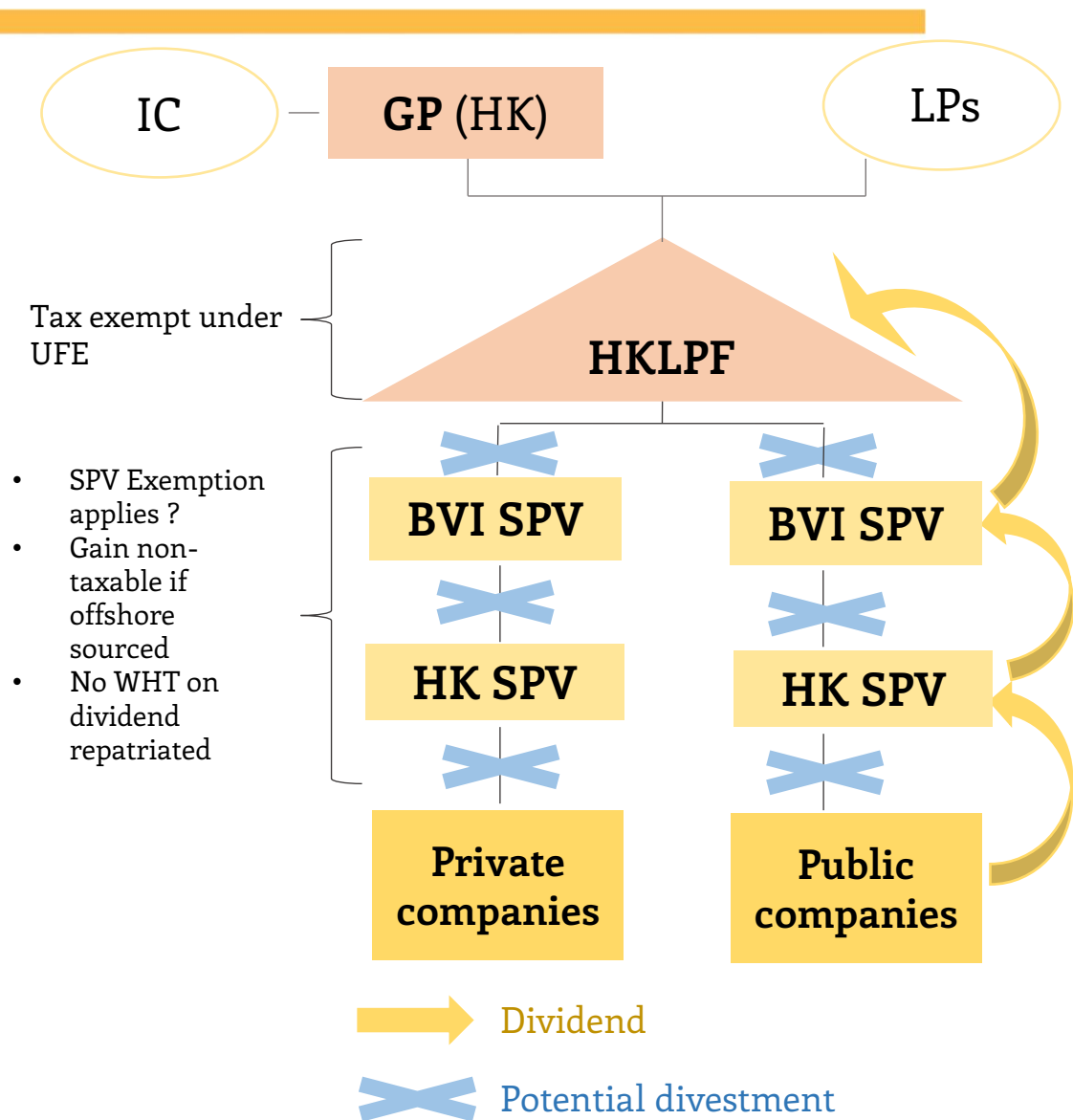
BVI SPV

- Gain exempt from HKPT under SPV Exemption
- Dividend income non-taxable
- No WHT on dividend repatriation
- Gain on direct / indirect transfer of PRC Co may be subject to PRC capital gains tax of 10% unless exempt under the DTA (see below)

HK SPV

- Gain exempt from HKPT under SPV Exemption
- PRC dividend WHT could be reduced from 10% to 5% on dividend repatriated from PRC Co to HK SPV under PRC-HK DTA if HK SPV holds at least 25% of the PRC Co for at least 12 months and meets “beneficial ownership” requirements
- Gain exempt from PRC capital gains tax if HK SPV holds not more than 25% of the PRC Co for at least 12 months and PRC Co is not land rich in China

Investing in private vs public companies



Investments in public companies at SPV level prima facie not exempt, except -

Private companies going public

- UFE / SPV Exemption continues to apply
- DIPN 61: *If the fund sells its investment in the investee private company through an IPO, it is in substance no different from a transaction in listed securities or a transaction in securities of an investee private company*

Public companies going private

- DIPN 61: *If a listed company after privatization is sold as an investee private company, the fund will continue to be exempt from profits tax provided the same exemption conditions have been fulfilled*

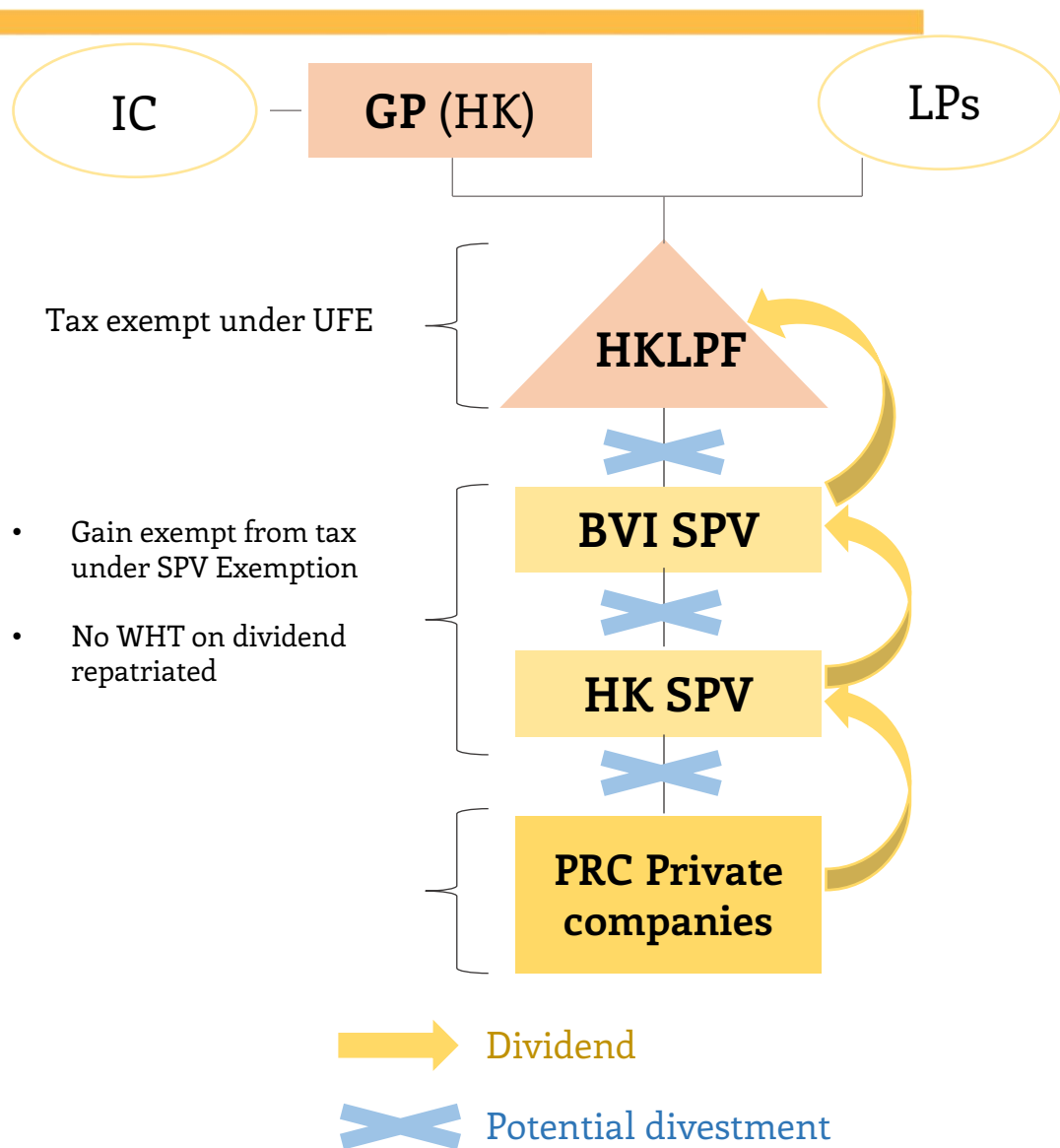
Investing in public companies

- Investment in listed securities directly by a Fund is qualifying transaction under UFE
- SPV Exemption only applies to SPV holding investee private company, but not listed shares?
- Technically, SPV Exemption does not apply if the Fund holds listed shares indirectly via SPVs

Offshore Model

- If the UFE does not apply, profit may still be exempt if offshore sourced, capital in nature, or otherwise exempt under the IRO (e.g. dividend)
- For block trades / private placement:
 - Negotiation and execution of legal documents outside of HK
 - IC, GP should make investment / divestment decision outside HK
 - Board meetings offshore
 - Offshore bank account for fund flows
 - Supporting documents e.g. board minutes

LPF structure for HK investment



LPF

- Exempt from HKPT under UFE
- The Fund itself is not permitted to engage in activities undertaken for general commercial or industrial purposes

BVI SPV

- Gain exempt from HKPT under SPV Exemption
- Dividend income non-taxable
- No WHT on dividend repatriation

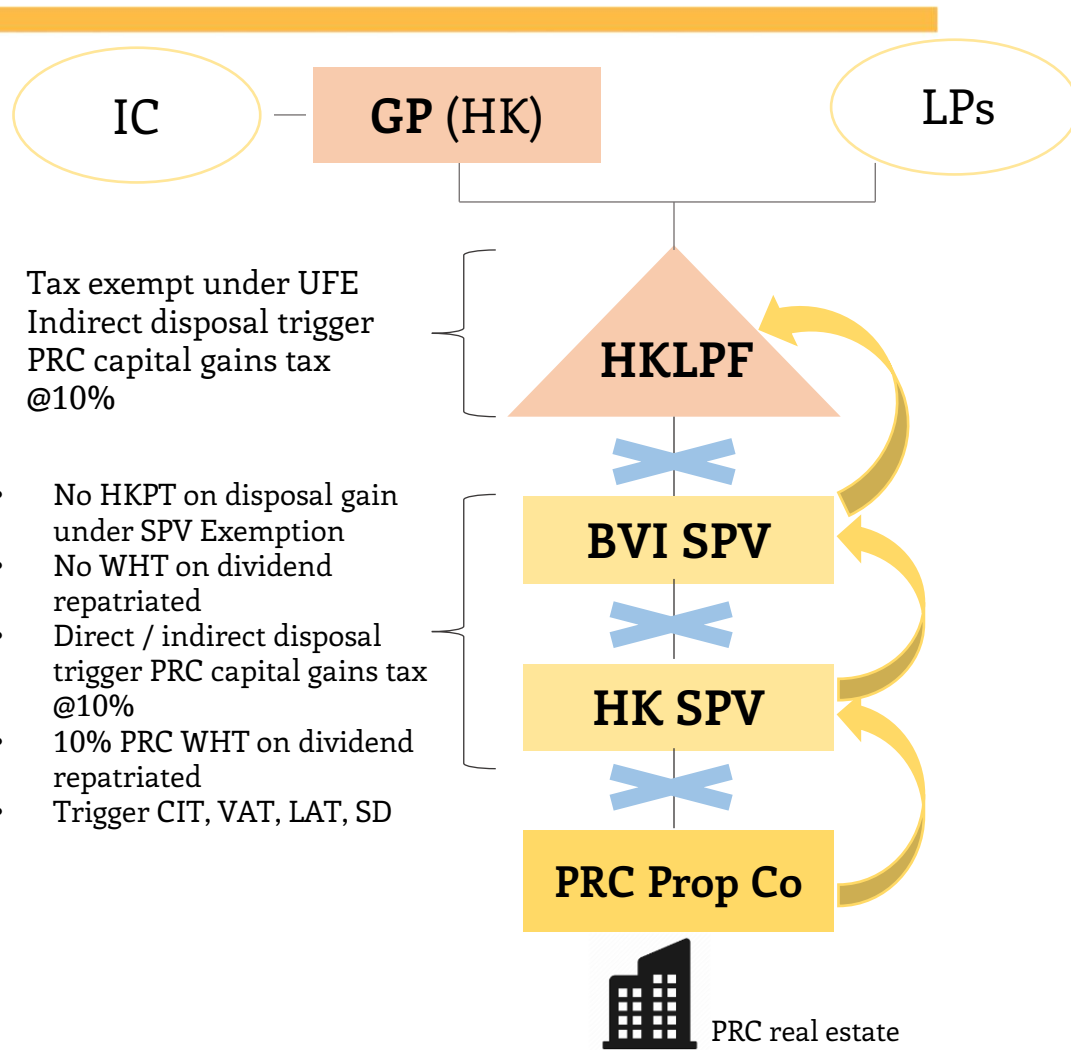
HK SPV

- Gain exempt from HKPT under SPV Exemption
- Dividend income non-taxable
- No WHT on dividend repatriation

Note

- Exclusions apply
 - HK property (>10% of company's asset value)
 - Short-term assets (>50% company's assets)
- But this can be mitigated by having appropriate investment protocols to structure the investment offshore

LPF – Chinese Real Estate



Investing in non-HK real estate

LPF

- Qualifying investment
- Exempt from HKPT under UFE
- PRC Capital gains tax @10% upon indirect disposal of PRC Prop Co

BVI SPV

- Gain exempt from HKPT under SPV Exemption
- 0.2% HK Stamp duty on transfer of HK shares
- Dividend income non-taxable
- No WHT on dividend repatriation
- PRC capital gains tax @10% upon indirect disposal of PRC Prop Co

HK SPV

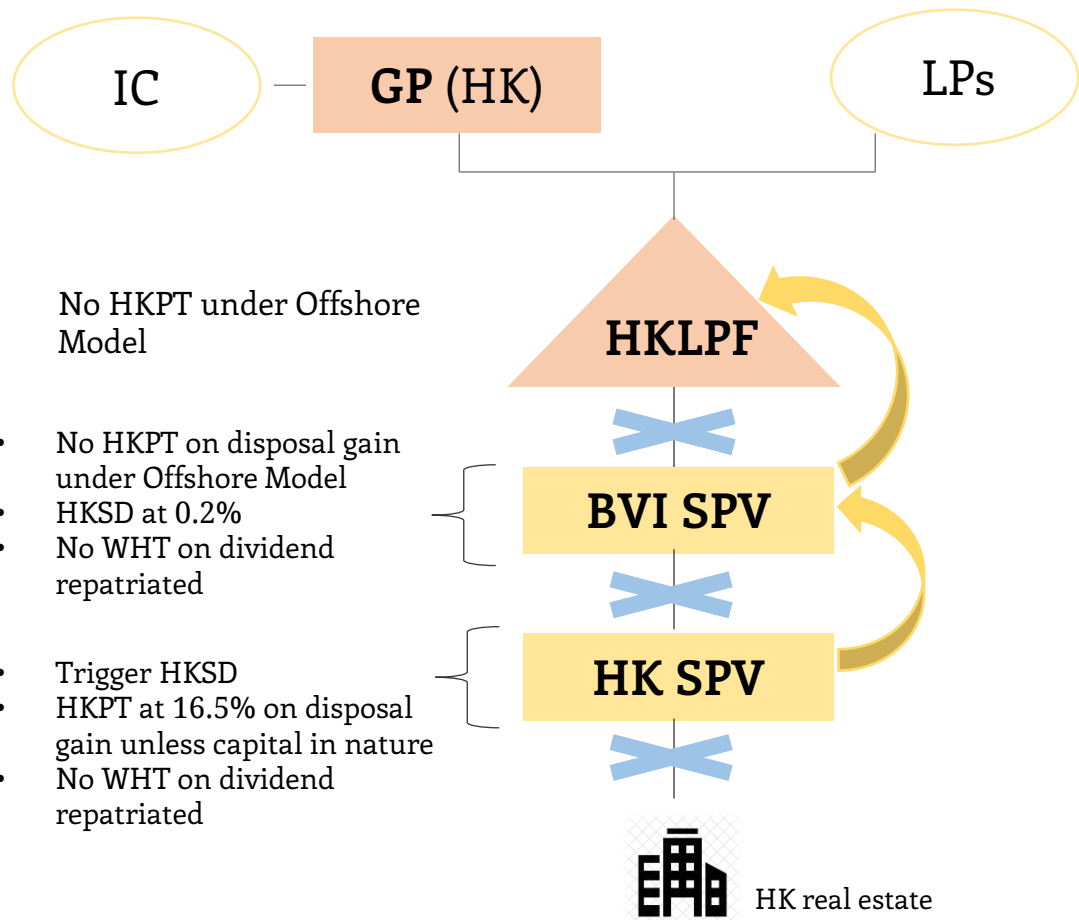
- Gain exempt from HKPT under SPV Exemption
- Dividend income non-taxable
- PRC capital gains tax @10% upon direct disposal of PRC Prop Co

PRC Prop Co

- 10% PRC WHT on dividend repatriation
- PRC CIT, VAT, LAT, SD implications

➔ Dividend ✕ Potential divestment

LPF – HK Real Estate



➔ Dividend ✕ Potential divestment

Investing in HK real estate

LPF

- Not a qualifying transaction. Under the UFE, the aggregate value of the immovable property held in HK cannot exceed 10% of the gross value of the investee company's assets

Offshore Model

- Adopt Offshore Model for HK real estates investment
 - Role of HK Fund Manager restricted to making investment recommendations to IC / GP. Possess no discretionary power to approve the investments / divestments
 - IC / GP should make investment / divestment decision outside HK. Board meetings offshore
 - Consider composition of IC and Board elsewhere
 - Negotiation and execution of legal documents outside of HK
 - Offshore bank account for fund flows
 - Supporting documents e.g. board minutes, travel, records

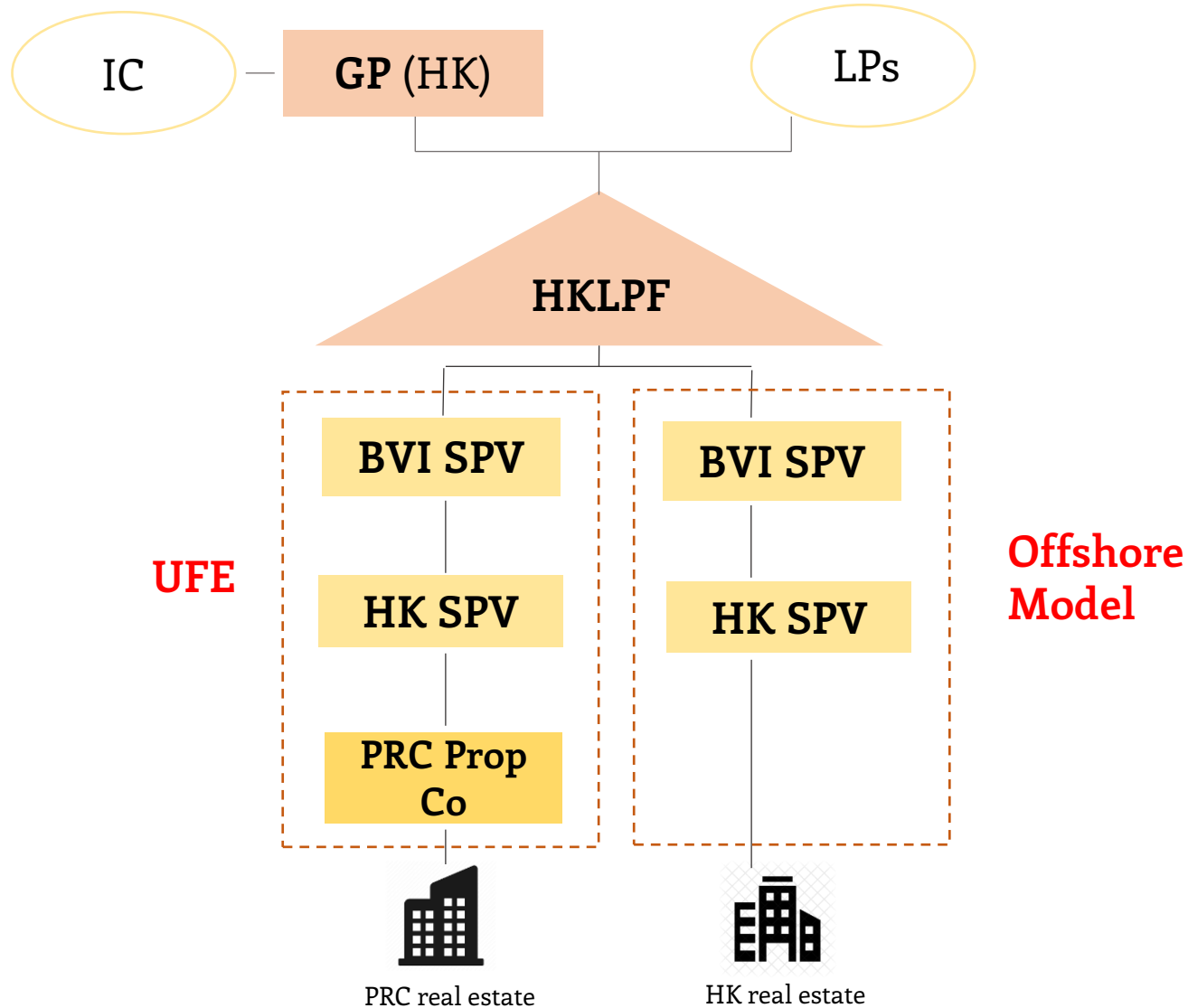
BVI SPV

- Not exempt under SPV Exemption
- 0.2% HK Stamp duty on transfer of HK shares
- Dividend income non-taxable
- No WHT on dividend repatriation

HK SPV

- HK Stamp duty on transfer of HK immovable property
- Disposal gain @16.5% unless capital in nature
- No WHT on dividend repatriation

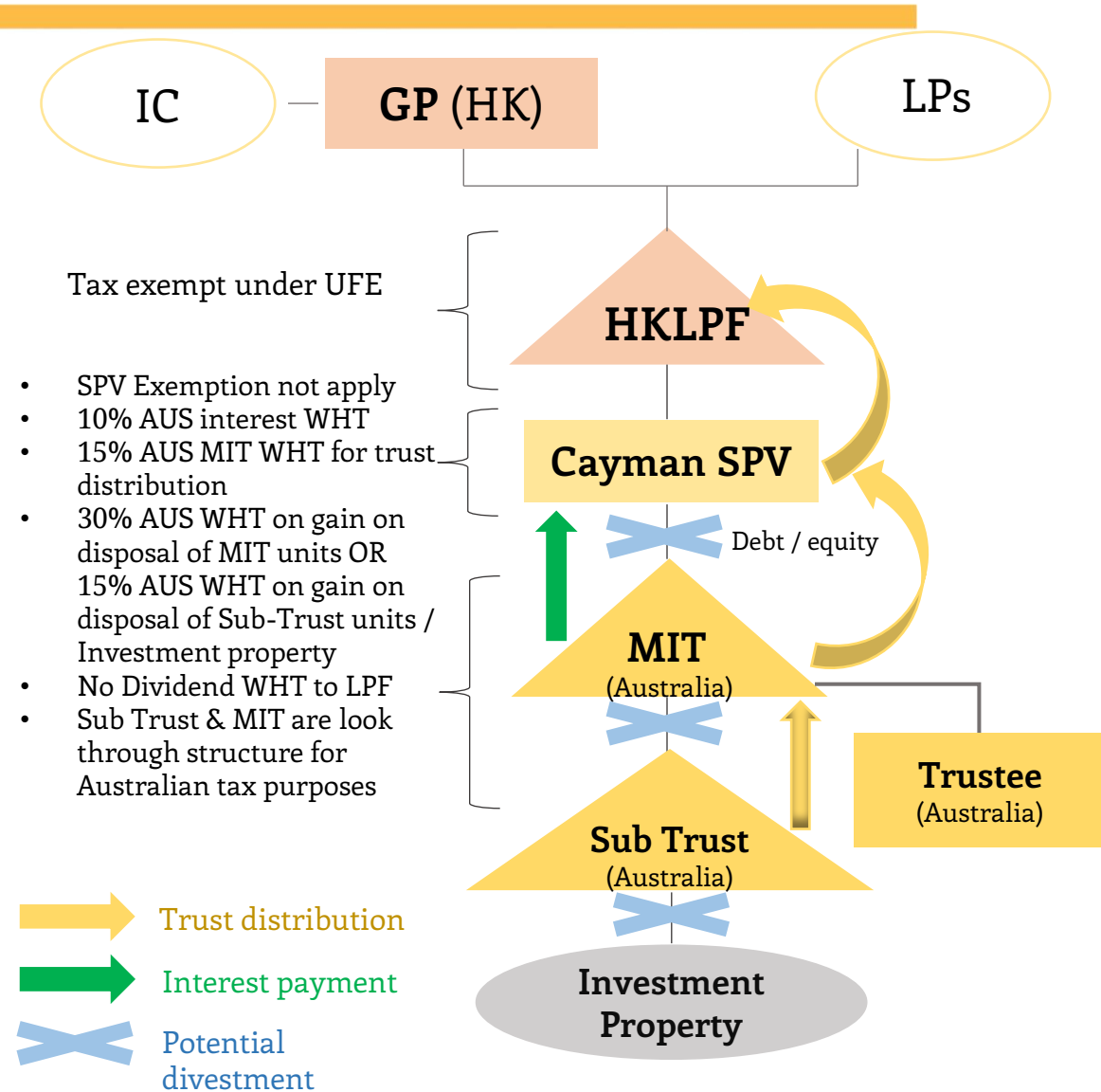
LPF – Real Estate Fund



Real Estate Fund

- Careful tax structuring
- Adopt a combination of UFE and Offshore Model
- Robust governance and operating protocols including the role of the Investment Committee and board meetings approving investment and divestment decisions

LPF structure for MIT investment



LPF

- UFE / SPV Exemption applies ?
- No WHT on dividend repatriation

Cayman SPV

- SPV Exemption not apply as MIT is a trust instead of a private company
- 10% Australian interest WHT on interest payment from MIT
- 15% Australian WHT for trust distribution from MIT
- 30% Australian WHT on gain on disposal of MIT units (exit typically by way of disposal of units in Sub Trust or underlying Investment Property due to tax efficiency)
- 15% Australian WHT on gain on disposal of Sub Trust units or underlying property
- No WHT on dividend repatriation to LPF

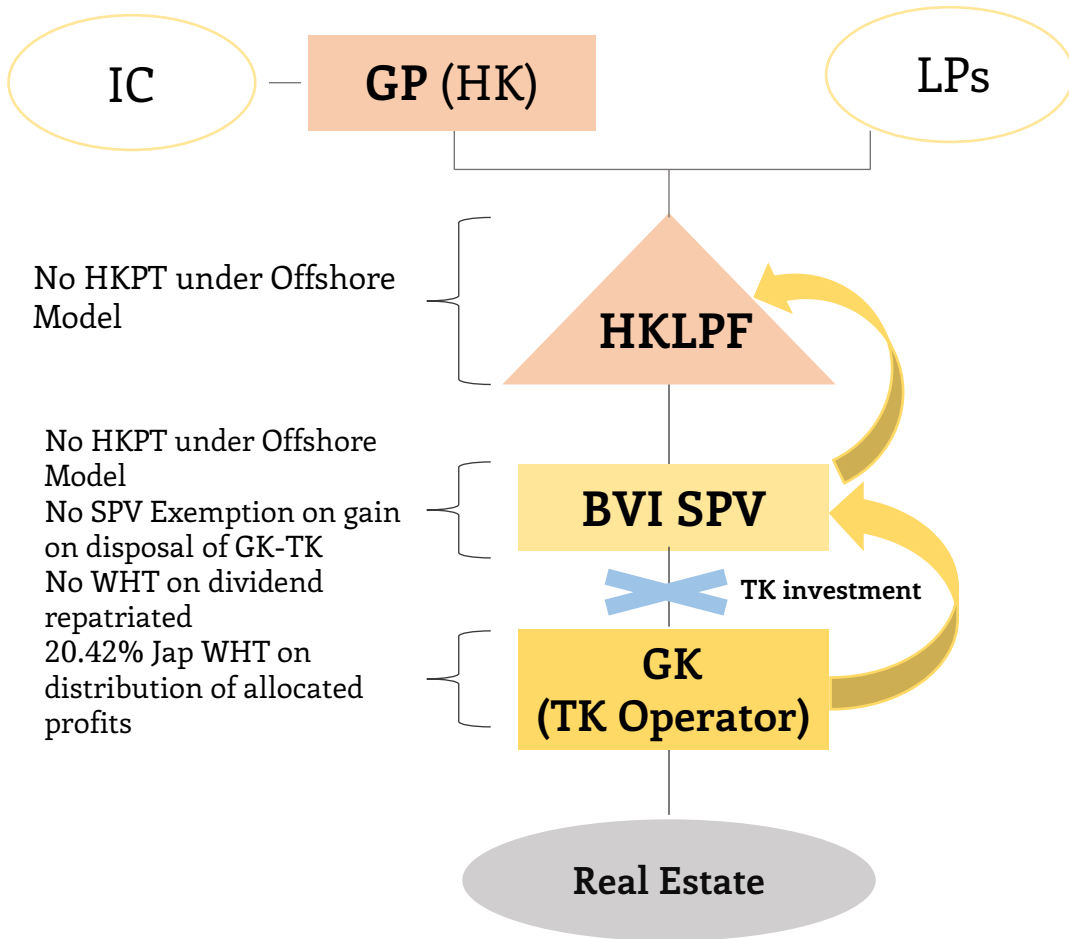
Managed Investment Trust (MIT)

- Look through structure for Australian tax purposes

Sub Trust

- When making multiple investments in Australia, sub-trusts can be established under the MIT (for bankruptcy remoteness purposes) to hold each Australian investment property asset, without increasing the overall Australian tax cost
- Look through structure for Australian tax purposes

LPF structure for GK – TK investment



No HKPT under Offshore Model

- No HKPT under Offshore Model
- No SPV Exemption on gain on disposal of GK-TK
- No WHT on dividend repatriated
- 20.42% Jap WHT on distribution of allocated profits

LPF

- Not a qualifying investment, so need to adopt the Offshore Model
- TK investment is a contractual arrangement and does not represent equity investment in the TK operator

BVI SPV

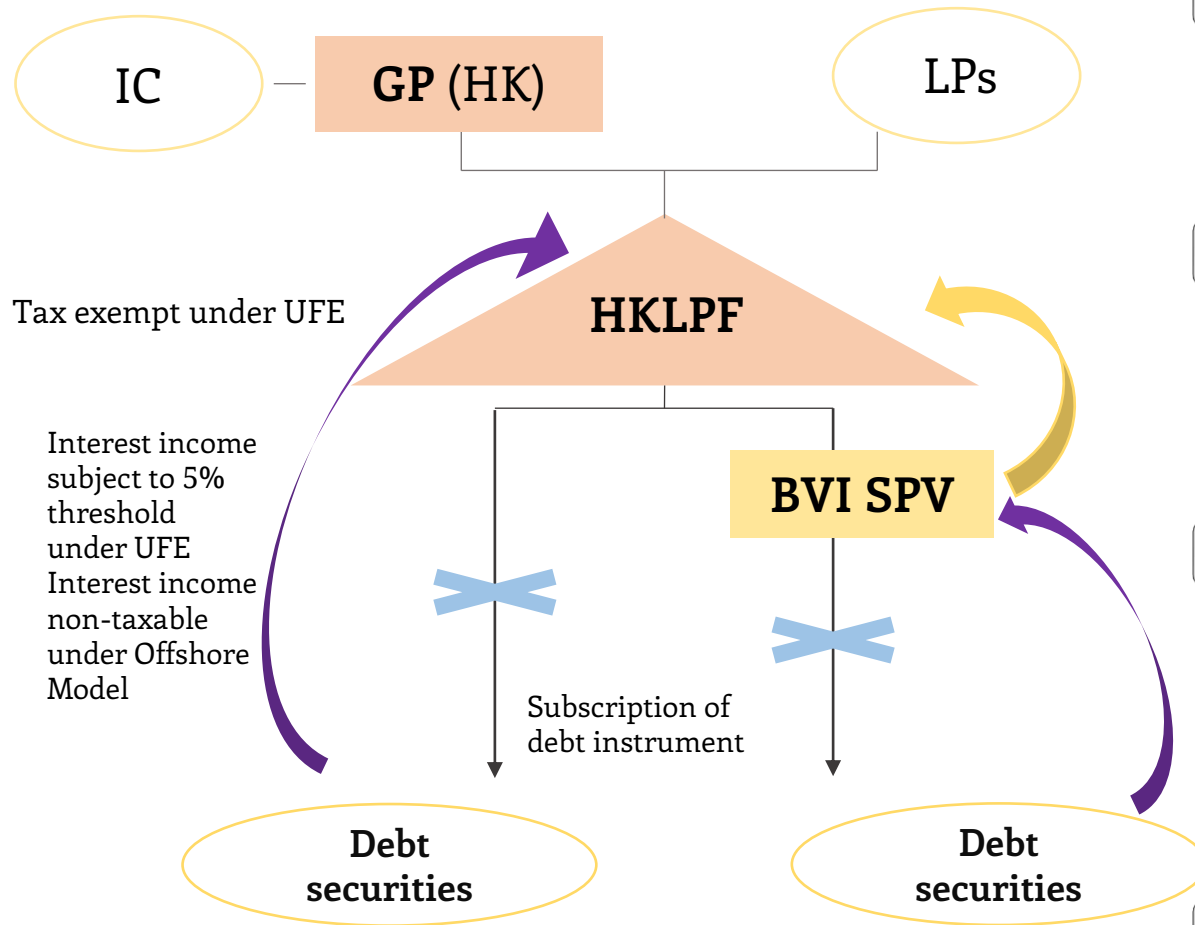
- No WHT on dividend repatriation
- SPV exemption not applies to gain on disposal of GK-TK contractual arrangement
- No HKPT under Offshore Model
- 20.42% Japanese WHT on distribution of allocated profits

Offshore Model

- Adopt Offshore Model for GK-TK contractual arrangement
 - IC, GP should make investment / divestment decision outside HK
 - Board meetings offshore
 - Negotiation and execution of legal documents outside of HK
 - Offshore bank account for fund flows
 - Supporting documents e.g. board minutes, travel records

 Allocated profits
  Potential divestment

Debt Fund – investing in debt securities



Tax exempt under UFE

- Interest income subject to 5% threshold under UFE
- Interest income non-taxable under Offshore Model

Debt investments

- Transactions in listed bonds, listed debt instruments and unlisted bonds and debt instruments issued by a private company that fulfills the qualifying tests should be considered as qualifying transactions
- Investment gain on trading in debt investments exempt under UFE / SPV Exemption

Interest income

- The holding of a debt instrument (e.g. debentures, loan stocks, bonds or notes) to earn “interest income” is not a transaction in securities
- The receipt of interest could only be considered as an incidental transaction subject to the 5% threshold. If interest income exceeds 5% of the total trading receipts, the entire interest income will be subject to HKPT if HK sourced

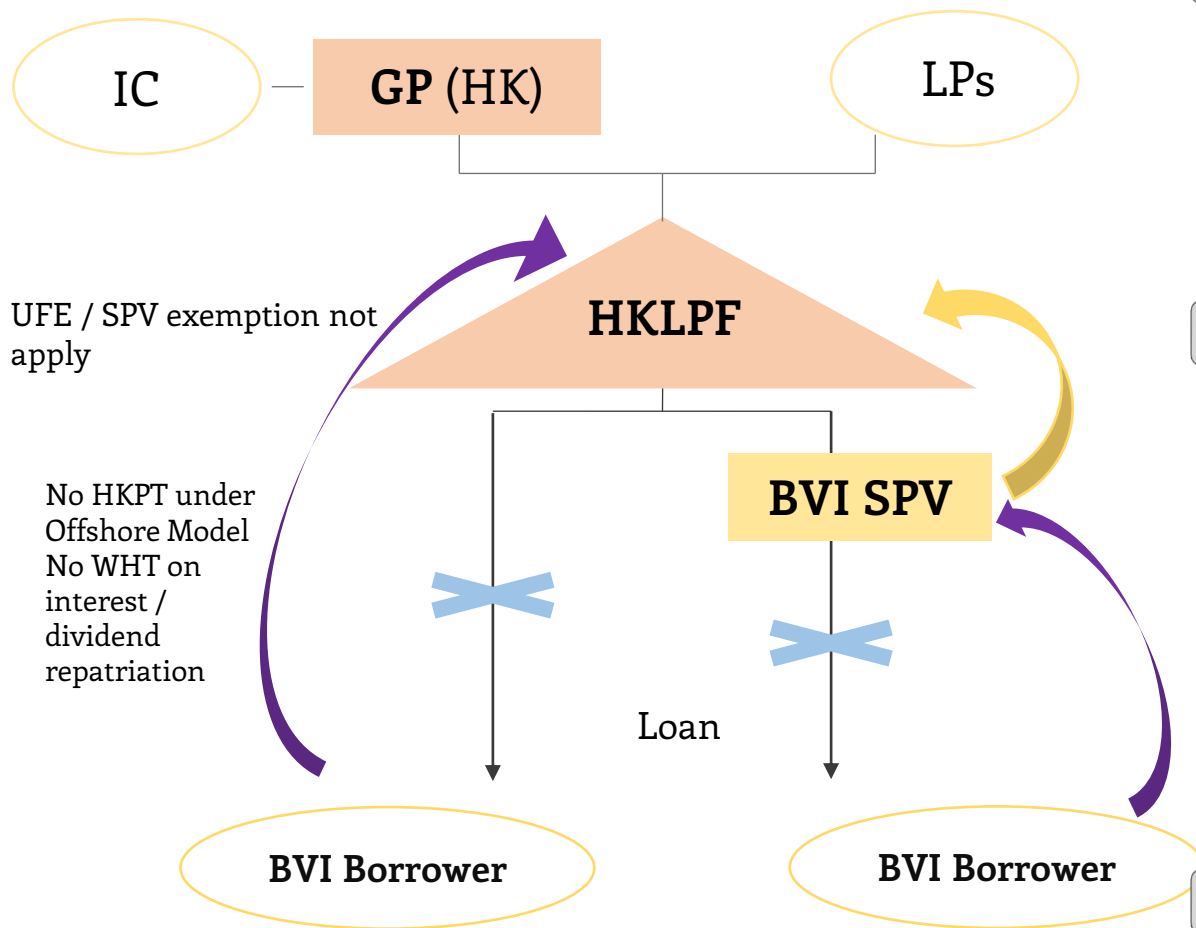
Offshore Model

- Provision of credit test: funds first made available to the issuer / borrower outside of HK
- Operations test: all the key activities that lead to the earning of interest income conducted outside of HK
 - IC, GP should make investment / divestment decision outside HK
 - Board meetings offshore
 - Negotiation and execution of legal documents outside of HK
 - Offshore bank account for fund flows
 - Supporting documents e.g. board minutes, travel records

BVI SPV

- Economic Substance requirements ?
- Investment in debt instruments not considered as “financing and leasing” activities

Debt Fund – loans



UFE / SPV exemption not apply

- No HKPT under Offshore Model
- No WHT on interest / dividend repatriation

Investing in loans

- Qualifying transactions ? “Making of **deposits** other than those made by way of a money-lending business” ?
- DIPN 61: *Though “deposit” is defined to mean “a loan of money”, this asset class “deposit other than by way of a money-lending business” should not cover “loan”, whether made out or acquired as investment*

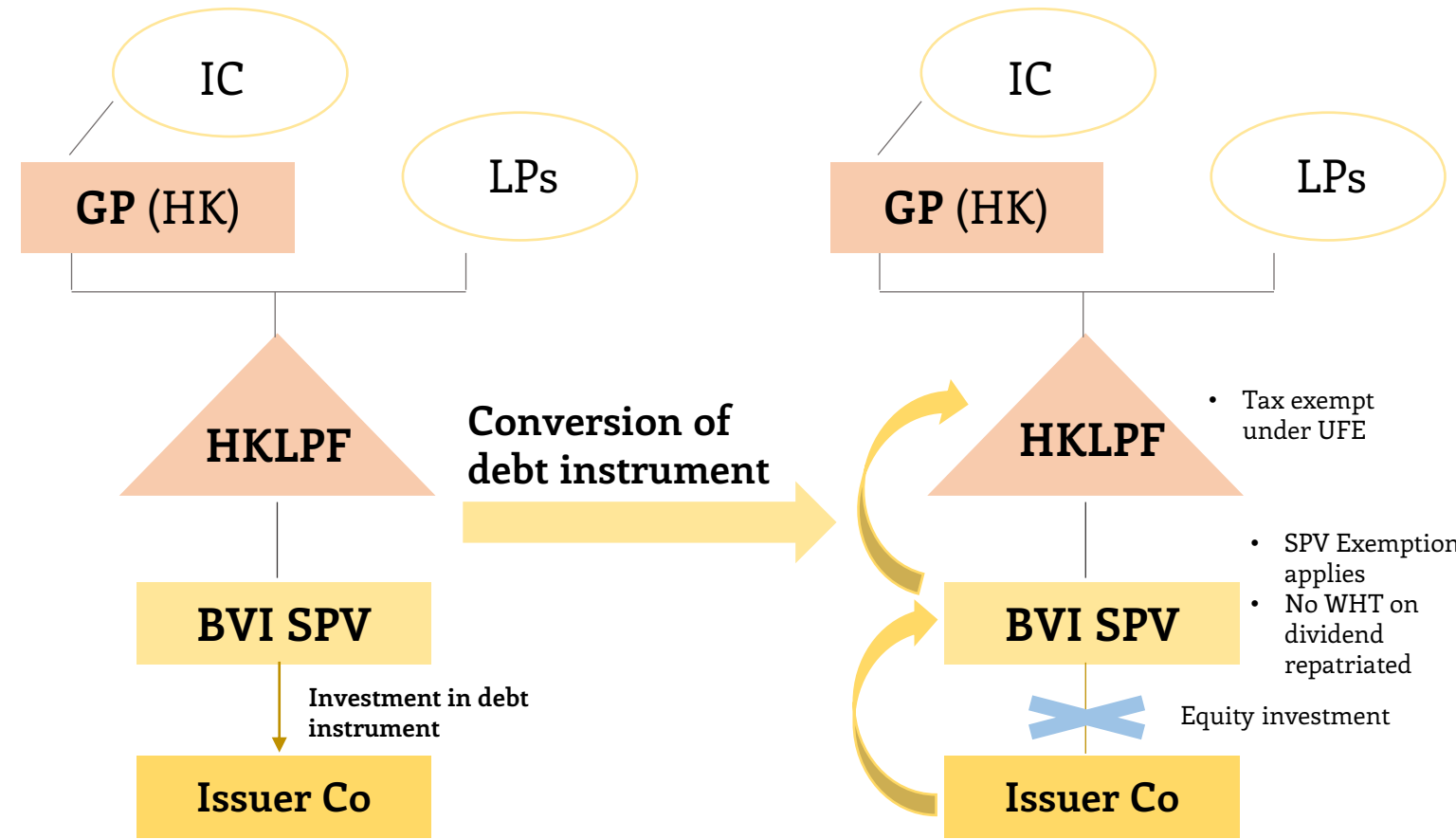
Need to follow the Offshore Model

- Provision of credit test: funds first made available to the issuer / borrower outside of HK
- Operations test: all the key activities that lead to the earning of interest income conducted outside of HK
 - IC meetings, GP board meetings outside of HK
 - Debt subscription agreements negotiated, executed and concluded outside of HK
 - Negotiation and conclusion of the loan terms outside of HK
 - Funding from the Fund’s offshore bank account to issuer’s offshore bank account

BVI SPV

- Economic Substance requirements ?
- Investment in loan not considered as “financing and leasing” activities ?

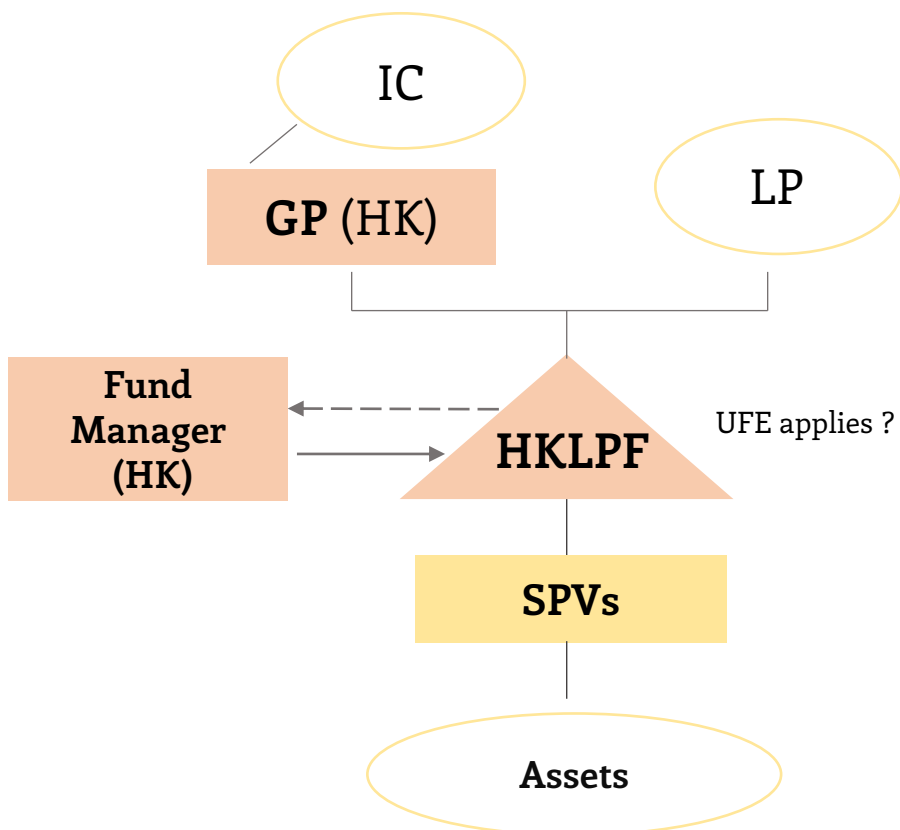
Debt Fund – debt conversion to equity



Debt conversion to equity (private or public equity)

- Conversion of loan into equity may qualify as exempt under UFE / SPV Exemption
- Prior to conversion, tax treatment follows debt investments
- Upon conversion, becomes an investment in private or public company

 Dividend  Potential divestment



Fund-of-one

- Is it a “collective investment vehicle” for UFE purposes ?
- Section 20AM(2) either satisfies the condition that the arrangement must provide (1) for the property to be managed as a whole by, or on behalf of, the person operating the arrangement **OR** (2) for the contribution of the persons participating in the arrangement and the profits or income to be pooled;
- DIPN 61: “may be accepted or continue to be accepted as a fund even if it has one investor at a certain point in time ... (e.g. during the start-up period or winding-down period)”
- DIPN 61: ‘an arrangement intended to have one single investor only is **unlikely** an arrangement under which the capital contributions and profits or income are pooled and would not satisfy the pooling requirement’
- Contradicting views between Section 20AM(2) and DIPN 61, it is unclear if a Fund-of-one which is managed by a fund manager could qualify as a Fund
- May adopt Offshore Model

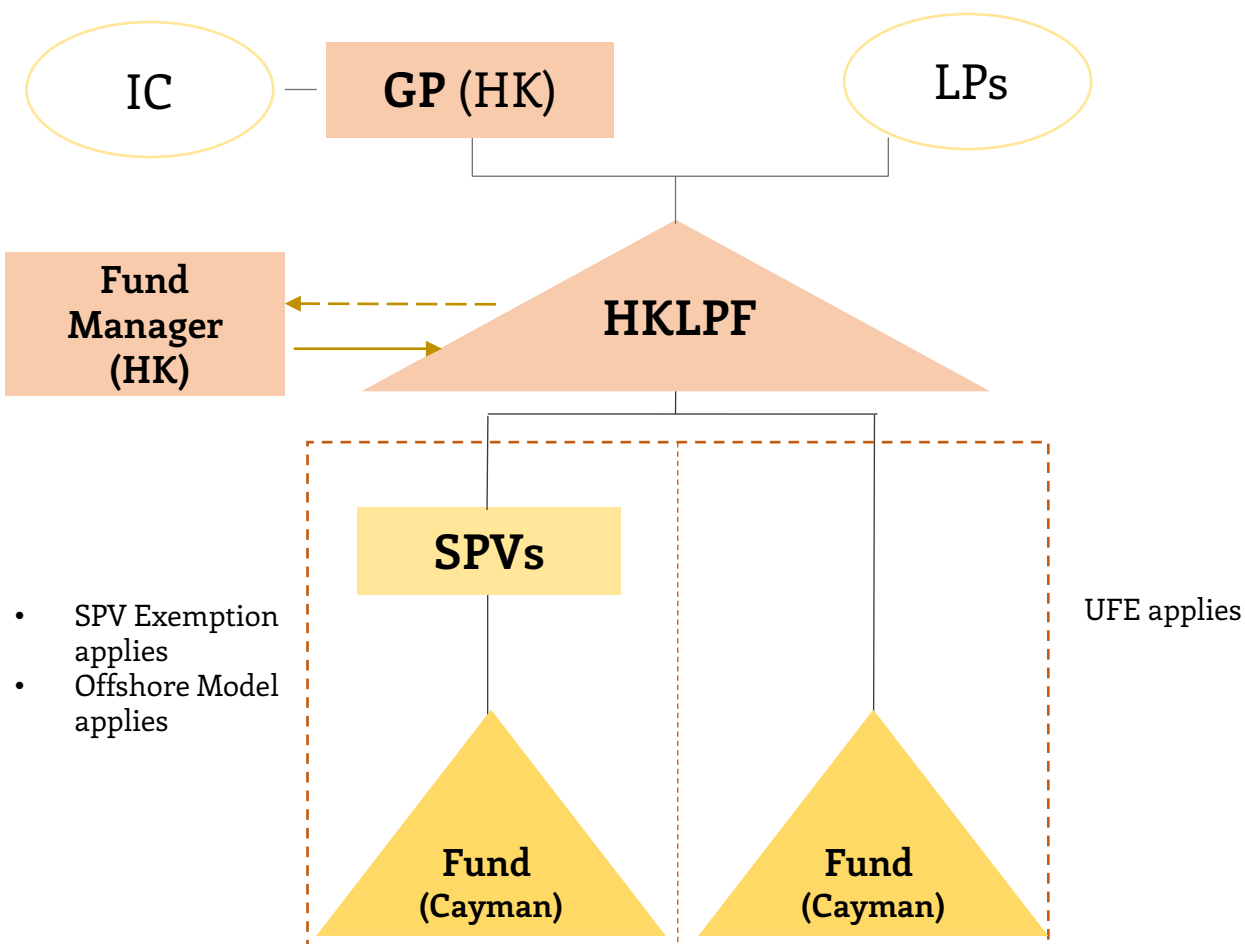
Sovereign fund

- Specifically regarded as a fund under Section 20AM(4) of Inland Revenue Ordinance
- Exempt from tax under UFE

Pension fund / Endowment Fund

- A national pension fund, as a limited partner of a fund, would be counted as one investor by the IRD, may be viewed as Fund-of-one not qualifies as Fund under Section 20AM(2).
- But Pension Fund / Endowment Fund are managed by fund manager, therefore should satisfy the condition that “*the arrangement to be managed as a whole by the person operating the arrangement*”.

Fund of funds



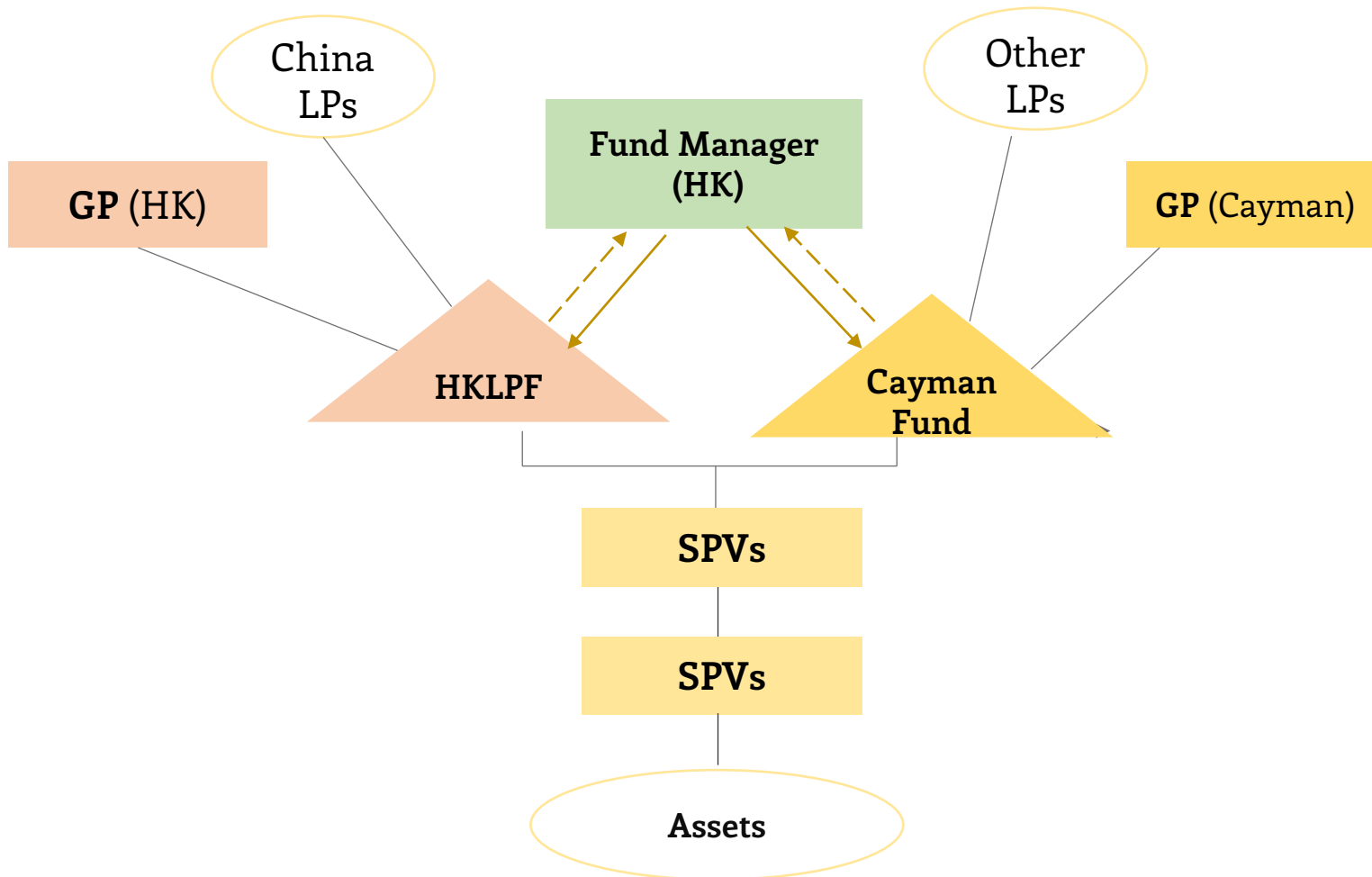
Investing in funds

- Investment in funds directly by LPF is qualifying transaction and UFE applies
- However, an investment in a fund through a SPV may not qualify ?
- Distributions from funds should always be exempt from tax
- If sell investment in another fund, may need to follow Offshore Model

Offshore Model could work

- Adopt Offshore Model for Fund of fund
 - IC, GP, BVI SPV should make investment / divestment decision outside HK
 - IC, GP Board, BVI SPV meetings offshore
 - Legal agreements negotiated, executed & concluded offshore
 - Offshore bank account for fund flows
 - Supporting documents e.g. board minutes, travel records

Using LPF in conjunction with other fund structures – Parallel Fund



HKLPF as parallel fund

- LPs more familiar with a traditional Cayman structure may prefer to invest through Cayman Fund

Fund level (HKLPF or Cayman fund)

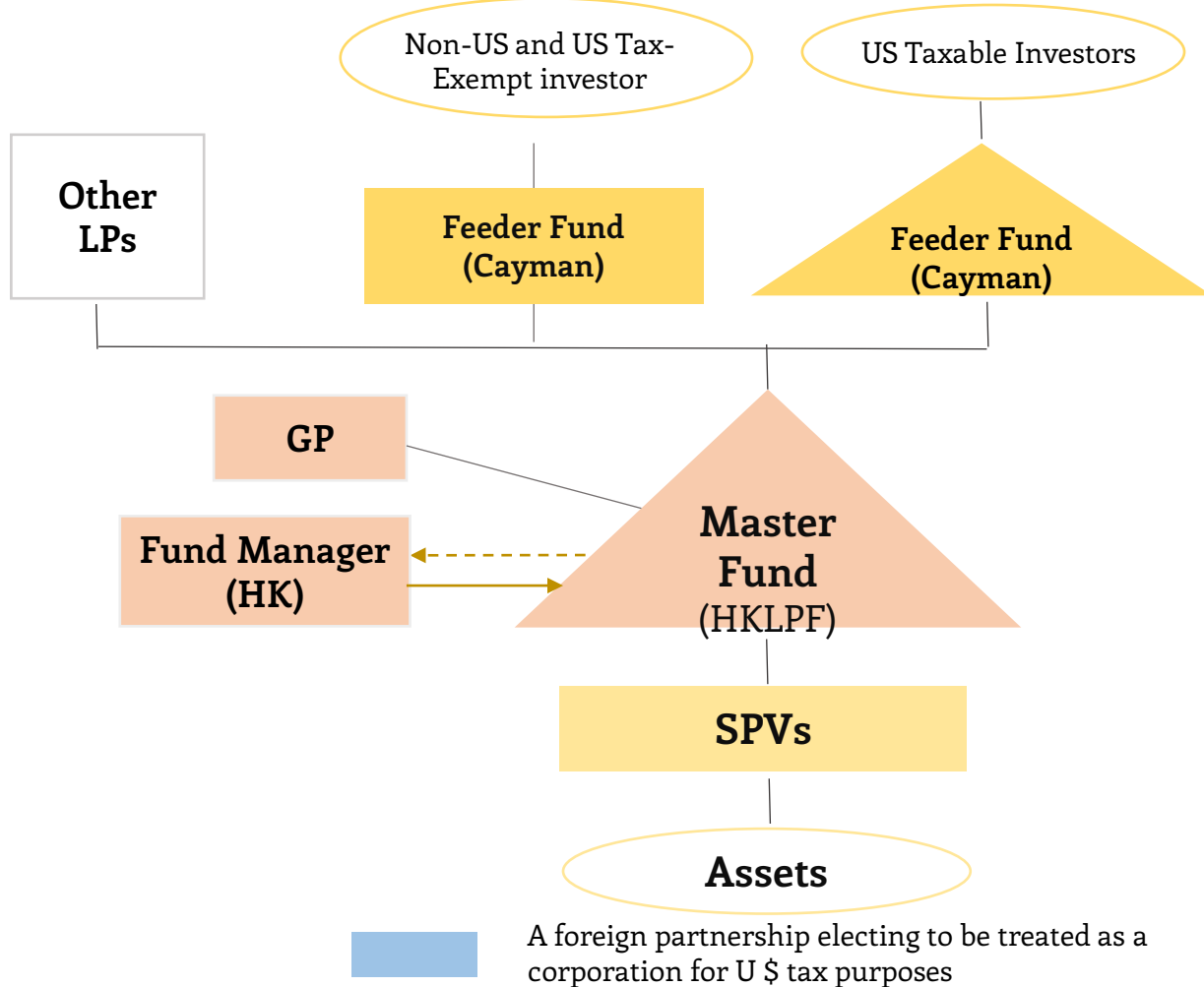
- Tax exemption under UFE

SPV level

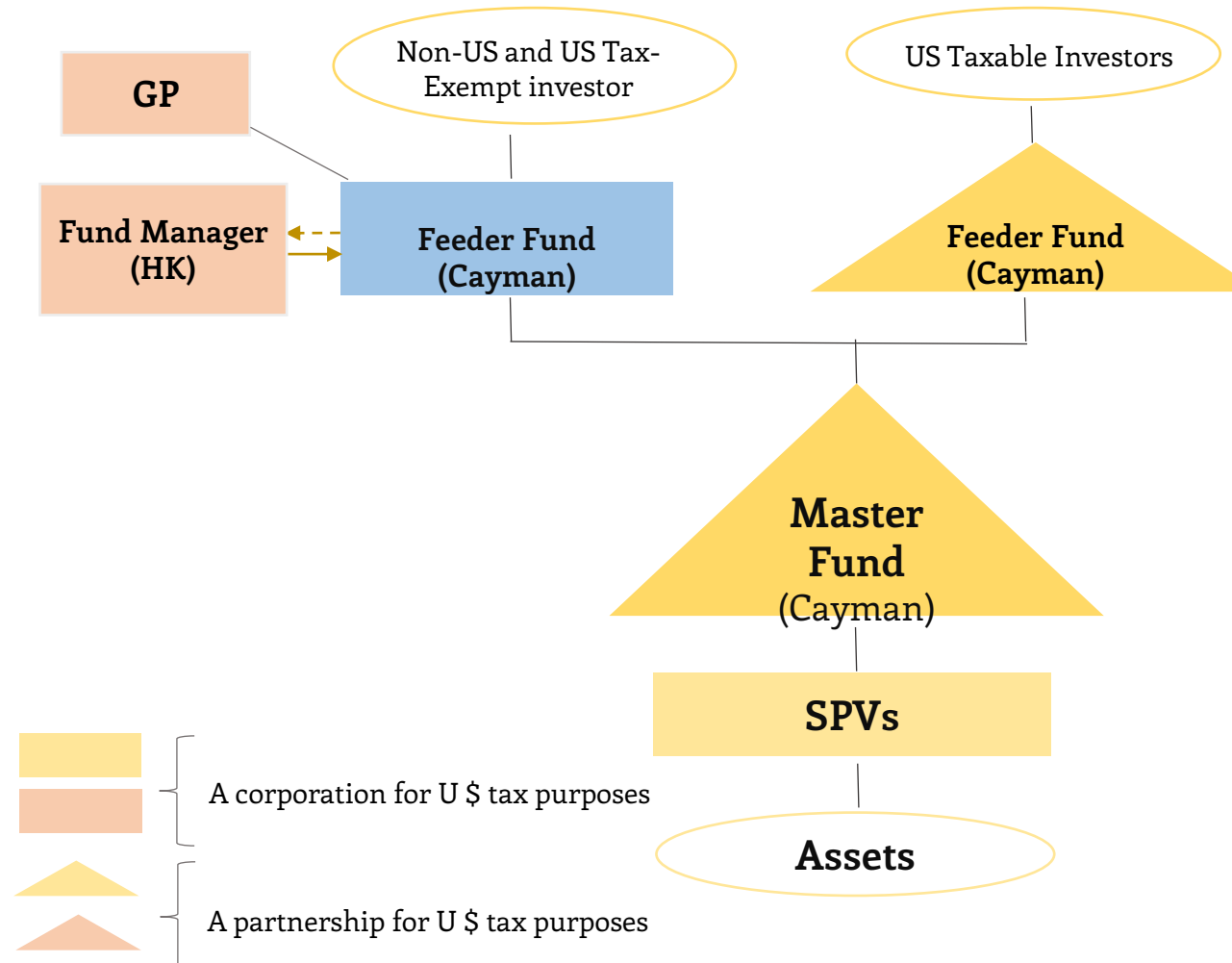
- Tax exemption under SPV Exemption

Master-Feeder Fund

HKLPF as Master Fund



HKLPF as Feeder Fund



Governance going forward

LPF is very flexible and should work well for most alternative assets classes

Most investments should fall within the UFE Exemption and LPF should clearly be exempt from tax

However, for investments that do not fall within the exemption, the investment should continue to be exempt under the Offshore Model

Essentially, a hybrid onshore fund management and “offshore” investment model case-by-case

Need robust and practical operating protocols involving the Investment Committee, GP and Investment Manager

Tax residence of funds – HK Tax Resident Certificate Status

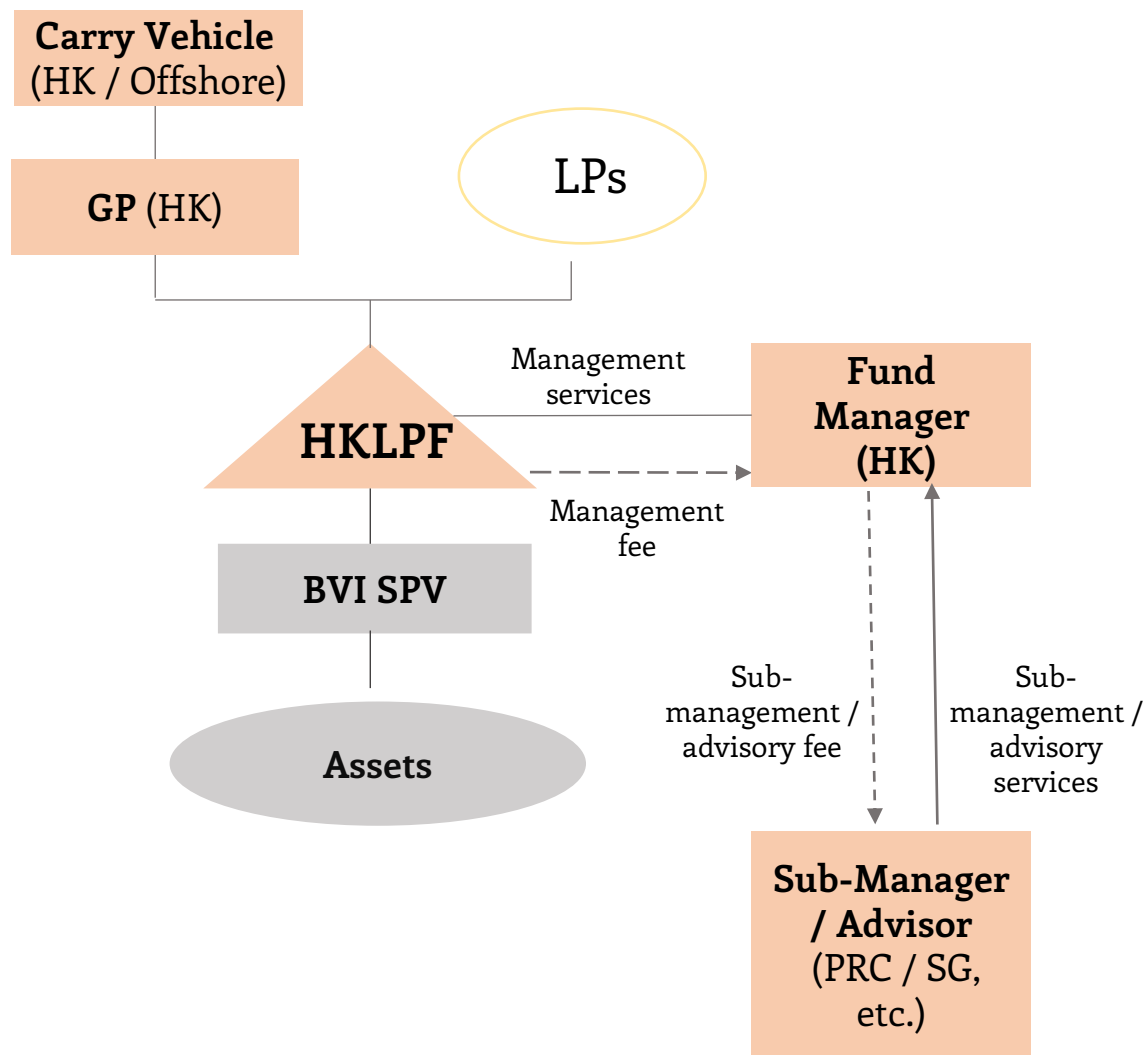
Tax residence of Funds

- LPFs should be able to get a TRC
- A TRC will be issued to a Fund if its CMC is exercised in HK
- An LPF's CMC must be exercised by the GP in HK
- DIPN 61: *If the regional investment platform of a fund is located in Hong Kong for acquisition and management of a diversified portfolio of private market investments in various territories in a regional grouping that includes Hong Kong and the decision to establish the regional investment platform in Hong Kong is mainly driven by the availability of fund executives with knowledge of regional business practices and regulations, then the benefits under a double tax agreement or arrangement should be available to the fund.*

Tax residence of SPV

- A TRC will be issued to a SPV if it can be provided that the SPV is a resident in HK
- Substantial business activities in HK ?
- *A SPV does not carry on any trade or activities except for the purpose of holding, whether directly or indirectly, and administering one or more investee private companies*
- DIPN 61: *as the operation of a SPV is very restrictive, its place of residence generally follows that of the private equity fund despite that the SPV might be incorporated, registered or appointed in HK*

Management Fee arrangement



Allocation of management fees

- DIPN 61: *“The current practice relating to the taxation of investment managers remains unchanged.....the application of anti-abuse provisions to the taxation of investment managers, continue to be followed.”*
- IRD’s focus on the apportionment of management fees between a Fund’s HK Fund Manager and offshore Investment Advisor(s) – ensure the HK Fund Manager receives an **arm’s length return** for its services
- The IRD does not accept cost plus arrangements to remunerate Hong Kong Fund Manager, particularly where they have performed significant functions and bore considerable risks in HK
- Allocation of management fees between Onshore and Offshore (e.g. capital raising activities)
- Methodology accepted by the IRD

Proposed Carry Interest concession



Carry Vehicle
(HK / Offshore)

GP
(HK / offshore)

LPs

HKLPF

Fund Manager
(HK / offshore)

SPVs

Assets

Eligible Carried Interest

- Carry must arise only if there are profits for a period on the investments, or on particular investments or from disposal of the investment(s)
- Carry paid would vary with reference to the profits
- The return to external investors is also determined with reference to the same profits

Profit Tax Rate

- Eligible carried interest will be taxed at a 0% profits tax rate

Fund

- Fund under definition of UFE
- Validated by HKMA
- Appointment of an authorised local representative

Carry Interest

- Profit-related return
- Paid out of profits derived from “qualifying transactions” of the validated fund

Eligible recipients

- Applicable to carry vehicles or investment managers in HK
- Substance requirements for carry recipients

How CityLinkers can help

Our dedicated team brings together senior and ongoing operation monitoring and experienced subject matter experts and trusted specialists who can support you every step of the way to successfully set up of an LPF.

Provide market intelligence for market entry

Assess and advise on licensing requirements of the Investment Manager (IM)

Provide Day 1 compliance assistance

Advise on internal control governance and risk management policies and procedures

Support your Hong Kong Companies Registry filing

Tax planning and structuring for the LPF and its investments

Audit your LPF

Tax review and compliance for your LPF

Acting as Responsible Person (RP) under the capacity of an accounting professional

Support your LPF accounting and compile the net asset value report

About CityLinkers

CityLinkers Group (“we” or “CityLinkers”), is a group of companies, specialized in providing services of all aspects, including accounting, auditing, tax, company secretarial, compliance, fund raising, corporate finance, financial advisory, internal control, listing consultancy, risk management and trust administration.

Established in 2011, CityLinkers has assisted over 3,000 companies located in Hong Kong, China and other countries to date.

Our team comprises of former executives of multinational companies and listed companies, certified public accountants, chartered tax accountants, appraisers and financial analysts. CityLinkers have teams with a total of over 100 members in Hong Kong and established branch offices established in strategic locations such as Shanghai, Shenzhen, Hangzhou and Singapore.

Why CityLinkers

CityLinkers's support and outsourced expertise allows you to focus on what you do best – driving results and achieving your business objectives.

CityLinkers offers a wide breadth of capabilities and expertise, with bespoke solutions to match client needs and budgets. Our team is made up of well-trained company secretaries, accountants, investor service experts, lawyers and business consultants whose professionalism and integrity are the backbone of our business.

Our clients are served to support, manage and nurture their teams with speed and efficiency. Our applications are also highly scalable, which allows us to serve a diversified portfolio of both local and international organizations, from newly-set up private enterprises, to multi-nationals.

Contact Us



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