Hong Kong’s proposals for a limited partnership regime for funds

Financial Services Tax News Flash
August 2019

In brief

As announced in the Financial Secretary’s 2019-20 Budget Speech, the Hong Kong SAR Government has been “studying the establishment of a limited partnership regime for private equity funds, with a view to providing the industry with more fund choices.” A task force led by the Financial Services Branch, together with other government departments and regulatory bodies has come up with proposals to introduce a limited partnership regime for funds. The task force is seeking views from various organisations and will consider these to draft the bill for consideration by the Legislative Council in due course.

In this financial services tax news flash, we summarise the key proposals that market players should take note of, including private equity funds, venture capital funds, real estate funds, and infrastructure funds.

In detail

The objective of the proposals is to introduce a new piece of legislation to put in place a new limited partnership regime specifically for funds. This legislation will be separate from the antiquated Limited Partnerships Ordinance (or LPO), which does not cater to the needs of an investment fund, but will continue to apply to existing non-fund limited partnerships.

The proposals are set out under different categories as follows:

Proposed key characteristics of the limited partnership fund (or LPF) regime

- An LPF is a limited partnership fund used for the purposes of managing investments for the benefit of its investors.
- The LPF regime will be a registration scheme.
- The LPF has to have at least two partners (i.e. one general partner (GP) and one limited partner (LP)). The GP is to be a Hong Kong private company. A LP may be an individual, a corporation, a limited partnership, or any other body corporate.
- The LPF has to be constituted by a limited partnership agreement (or LPA), has to have a registered office in Hong Kong, and a business registration certificate.
- Generally, the LPF does not need SFC authorisation unless the LPF engages in activities that fall under the regulatory remit of the Securities and Futures Ordinance.
- The GP is to appoint an investment manager to carry out the day-to-day investment management functions. The investment manager is either an authorised institution, a licensed corporation, an accounting professional, or a legal professional (as defined). Again, if the investment manager carries out regulated activities, it should hold the requisite SFC licence(s).
- There is no minimum capital requirement or restriction on the investment scope for a LPF.
Registration requirements

- The proposals set out various requirements for the LPF to register with the Registrar of Companies (or RoC).
- The RoC is a registrar for the LPFs and will maintain and publish a register of LPFs.
- The RoC will also have sufficient enforcement powers to enable it to oversee LPF’s compliance with registration, annual return filing, and other requirements.

Tax and stamp duty treatment

- Like other funds, an LPF meeting the definition of a “fund” under the relevant section in the Inland Revenue Ordinance can enjoy profits tax exemption in Hong Kong provided it meets the exemption conditions.
- Given an interest in a LPF is not a share, stock, debenture, loan stock, fund, bond, or note issued by the LPF, nor is it a unit under a unit trust scheme, the interest is not a “stock” under the Stamp Duty Ordinance. As such, an instrument under which the LPF interest is contributed / transferred / withdrawn will not be chargeable to stamp duty in Hong Kong.
- In-kind capital contributions in relation to the transfer of dutiable assets (e.g. Hong Kong stock or immovable property) would be subject to stamp duty.
- The transfer of dutiable assets by a LPF to an LP would be subject to stamp duty.

Funds looking to migrate from the LPO to the LPF regime

- A fund already registered under the LPO can migrate to the LPF regime. Doing so would neither affect the identity nor continuity of the fund. If there will not be any transfer of assets or change in beneficial ownership, there should be no profits tax or stamp duty implications arising from the migration.

Others points to note

- **Contractual freedom among partners** – Each LPF will be governed by its LPA and the terms and conditions set out therein.
- **Safe harbour activities for LPs** – The proposals set out examples of certain safe harbour activities that LPs can carry out without affecting its limited liability protection. These safe harbour activities do not constitute LPF management activities. In coming up with such proposals, the task force sought the experience from similar regimes overseas.
- **LPF winding up** – The proposals suggest a straightforward and cost efficient dissolution and/or liquidation mechanism for LPFs, which would not compromise investor interests.
- The proposals also consider anti-money laundering / counter-terrorist financing requirements, record maintenance, powers of the Chief Executive in Council (CE in C) and the Court, offences and penalties, etc. In particular, the CE in C (or other authorities) will have powers to make rules relating to the LPF regime.
- **Audited financial statements** – the proposals require the LPF’s financial statements to be audited annually by a practice unit in accordance with the Hong Kong Financial Reporting Standards (or equivalent).

The takeaway

We are pleased to see that the Government has responded to the industry’s call for a modernised regime to cater for Hong Kong domiciled private equity funds and has come up with sound proposals to move this forward. The proposals reflect the need for a simple and easy to implement regime, and we await the details and bill to be issued in due course. We will provide you with more insights and updates as these arise.

We expect that these changes would bring a wealth of opportunities to Hong Kong, especially considering the pivotal role Hong Kong has to play in the Greater Bay Area. Complementing the open-ended fund company regime as an onshore vehicle for hedge funds, the LPF, as an equivalent for private equity, venture capital funds, real estate, and infrastructure funds, would encourage even more investment funds and fund managers to Hong Kong. This would give market players more flexibility in structuring and domiciliation with commercial substance.
Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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