

Tax Newsflash



Hong Kong Tax News

Breaking News: Profits Tax Exemption Law for Private Equity Funds in Effect

The Inland Revenue (Amendment) (No. 2) Ordinance 2015, published in the Gazette on 17 July 2015, extends profits tax exemption under the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2006 (the **Offshore Funds Law**) to nonresident private equity (**PE**) funds. This new legislation has been widely anticipated by industry and tax practitioners and is expected to boost the PE industry in Hong Kong. The legislation is effective as from 17 July 2015, and applies retroactively to transactions carried out from 1 April 2015.

The key measures, which are in accordance with those proposed in the Inland Revenue (Amendment) Bill 2015, are as follows:

Qualification of transactions in securities in an “excepted private company” as tax-exempt “specified transactions”: Broadly, an excepted private company could be an offshore portfolio company incorporated outside Hong Kong that fulfills certain conditions within a three-year “lookback” period, including not having a permanent establishment in Hong Kong and meeting 10% “de minimis” thresholds on its Hong Kong assets.

“Qualifying fund”: A nonresident PE fund that is not managed by a person licensed under the Securities and Futures Ordinance may enjoy the profits tax exemption if it is a bona fide PE fund that fulfills certain conditions, such as having at least five investors (aside from its originators and their associates) whose capital commitments exceed 90% of the fund's aggregate capital commitments.

Special purpose vehicle (SPV): A profits tax exemption will be available to an SPV in respect of profits derived from transactions in certain securities of an interposed SPV or an excepted private company (e.g. gains from the disposal of an offshore portfolio company or from the disposal of another SPV that owns an offshore portfolio company.) One of the key conditions for the SPV to qualify for such an exemption is that it be established solely for the purpose of holding, directly or indirectly, and administering one or more offshore portfolio companies.

Please see our [Tax Analysis](#) for a detailed discussion on the key aspects of new legislation of the Offshore Funds Law.

Impact on PE Fund and Fund Management Entities – How Deloitte Can Help

<p>Exemption for profits of a PE fund</p>	<p>A PE fund now may enjoy a profits tax exemption on gains arising from transactions in offshore portfolio companies and certain qualifying SPVs.</p>
	<p>Deloitte can:</p> <ul style="list-style-type: none"> • Assist in assessing whether the PE fund's investments would qualify as offshore portfolio companies under the new legislation. • Advise on potential ways to structure nonqualifying investments, if any, to help minimize the risk of "tainting" the PE fund's profits from other qualifying investments.
<p>Availing of treaty benefits</p>	<p>A qualifying SPV of the PE fund may be tax exempt in Hong Kong and eligible for tax treaty benefits, if properly structured.</p>
	<p>Deloitte can:</p> <ul style="list-style-type: none"> • Explore the feasibility of establishing a "super SPV" in a suitable jurisdiction to act as the investment platform for the fund, with a view to qualifying for treaty benefits under that jurisdiction's tax treaty network. • Advise on the practical aspects of building business substance in the SPV so that it could fulfill the conditions of the new Offshore Funds Law and avail of treaty benefits. • Advise on ways that potentially could help minimize the risk of triggering adverse tax consequences to the PE fund's investors that could arise from the SPV's business substance and activities (e.g. unrelated business taxable income to US tax-exempt investors).

Taxability of management fees

The new Offshore Funds Law allows more flexibility for certain fund management activities to be undertaken in Hong Kong without triggering profits tax exposure for the PE fund. For instance, the negotiation, conclusion and execution of definitive documents governing the PE fund's investments now may be undertaken in Hong Kong.

Increased level of activities in Hong Kong may impact the allocation of management fees between an offshore fund manager and a Hong Kong investment advisor.

Deloitte can:

- Revisit the operating protocol of the fund management group of the PE fund, and each entity's roles and functions.
- Assess the transfer pricing impact, if applicable, arising from increased fund management activity in Hong Kong.
- Explore a potential offshore claim on fund management fees, and advising on ways that will help support such a claim.

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