

# HKVCA Technical Committee



## Two-way Communication

John Levack  
Chm of Technical Committee  
30<sup>th</sup> April 2014

# HKVCA Technical Committee – feedback session



- Technical committee:
  - ‘why’ ?
  - ‘what does it do’ ?
- Technical issues – how much does the committee cover
- Discussion on some key, topical issues

# HKVCA Technical Committee



We launched a new committee of HKVCA in 4/2012 that brings together some of HK's leading advisers, in-house counsels and CFOs, with the objective of:

- Communicating with HKVCA members on legal and technical matters which affect them, their investors and their portfolio companies
- Shaping policy and the implementation of policy to ensure that it accommodates the needs of the HK venture capital and private equity community
- Raising the profile of the industry and its concerns with regulators, influencers and other key industry bodies

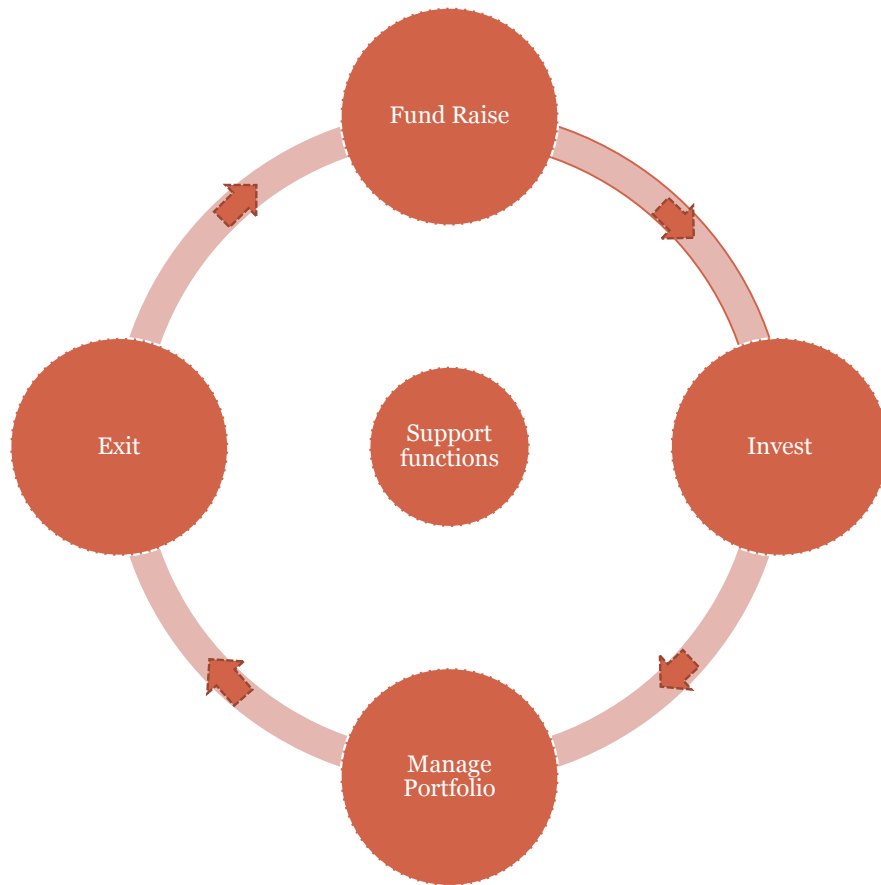
Projects currently underway:

- Liaising with HK Govt on a route map for bringing Funds and GPs onshore in HK
- Establishing a working group with the SFC to improve the regulatory framework for PE firms in HK
- HK UST study of indirect job creation by PE & Hedge funds and Survey of PRC Funds strategies
- Sub-committees: Carried interest working group, Limited Partnership re-drafting,...

The members of the committee are:

Asel Umurzakova	JP Morgan
Darren Bowdern	KPMG
David Pierce	Squadron
Denis Tse	Lockheed Martin
Everton Robertson	Travers Thorp
Florence Yip	PwC
Hebert Pang	New Horizon (CFO)
KO Chia	Grace
Jacqueline Petts	Silver Lake (Gen Counsel)
James Ford	O'Melveny & Myers
James Savage	Headland
Javed Rahman	Alter Domus
John Levack (Chm)	Electra
Joyce Chiong	Squadron (CFO)
Linda Wang	Hony (CFO)
Lorna Chen	Shearman & Sterling
Mark Shipman	Clifford Chance
Melissa Obegi	Bain Capital (Gen Counsel)
Patrick Cordes	Barings (CFO)
Shirley Xie	PwC
Simon Ho	IDG (CFO)
Susan Gordon	Deacons
Susannah Lindenfield	Blackstone (Gen Counsel)
Vanessa Chien	TPG (Gen Counsel)
Wayne Bannon	Carlyle (Gen Counsel)
Ying Zhang	Fangda

# PE firms' activities – traditional view

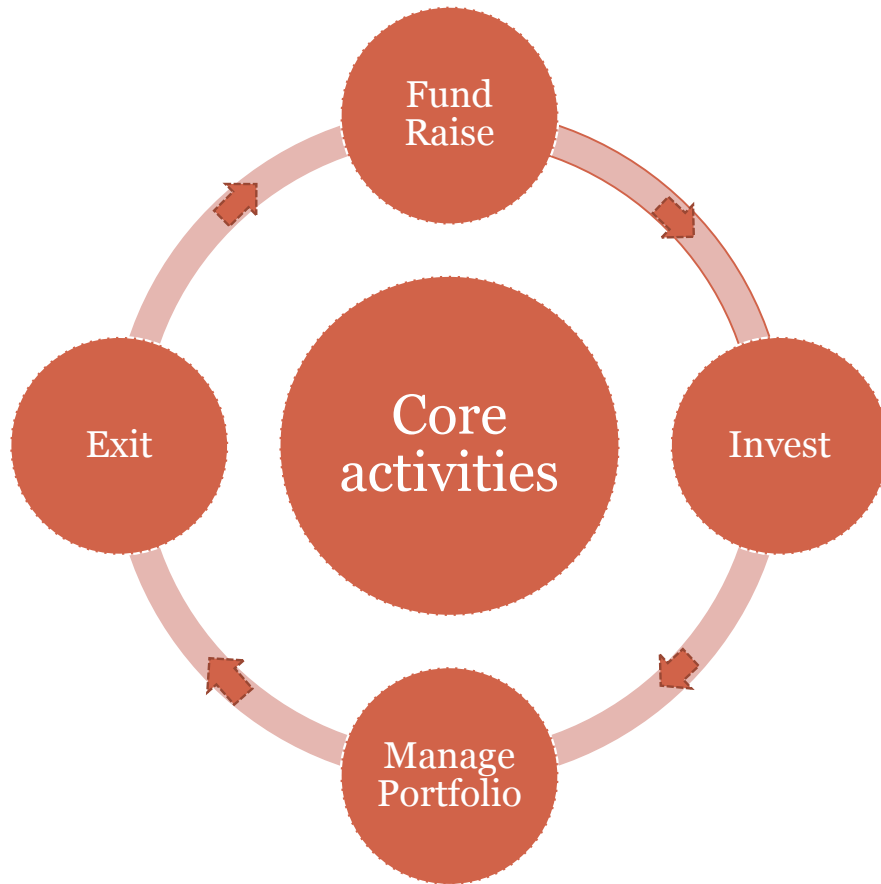


The critical activities of a PE firm:

- Fund raising
- Investment
- Portfolio management
- Exit

plus some support functions...

# Activities (& head count) changed...



The 'Core activities' of PE firms have become much more complex:

- Fund structuring
- Investment structuring
- Regulatory
- Compliance
- Reporting & investor relations

# Five years ago - *caricature*



## Agenda:

### ✓ Fund structuring

Cayman fund & manager, HK adviser (fees: cost plus)

### ✓ Investment structuring

Convenient tax havens with DTAs

### ✓ Regulatory

Optional in HK with SFC

### ✓ Compliance

We have a manual prepared years ago

### ✓ Reporting

Same as last time...

## Internal Meeting: CFO & General Counsel



# How much does the committee cover?



# Issues facing PE firms...



FCPA / UK  
Bribery Act

Treaty benefits:  
DTAs

China CGT

HK - OEIC & Ltd  
Partnership  
Law

IRD:  
carried interest

SEC Regulations

China  
structures

SFC regulations

ESG reporting

IRD  
Investigations:  
transfer pricing

FATCA

AIFMD

Qianhai /  
Shanghai FTZ

ILPA reporting

Offshore Funds  
Exemption

Little  
influence

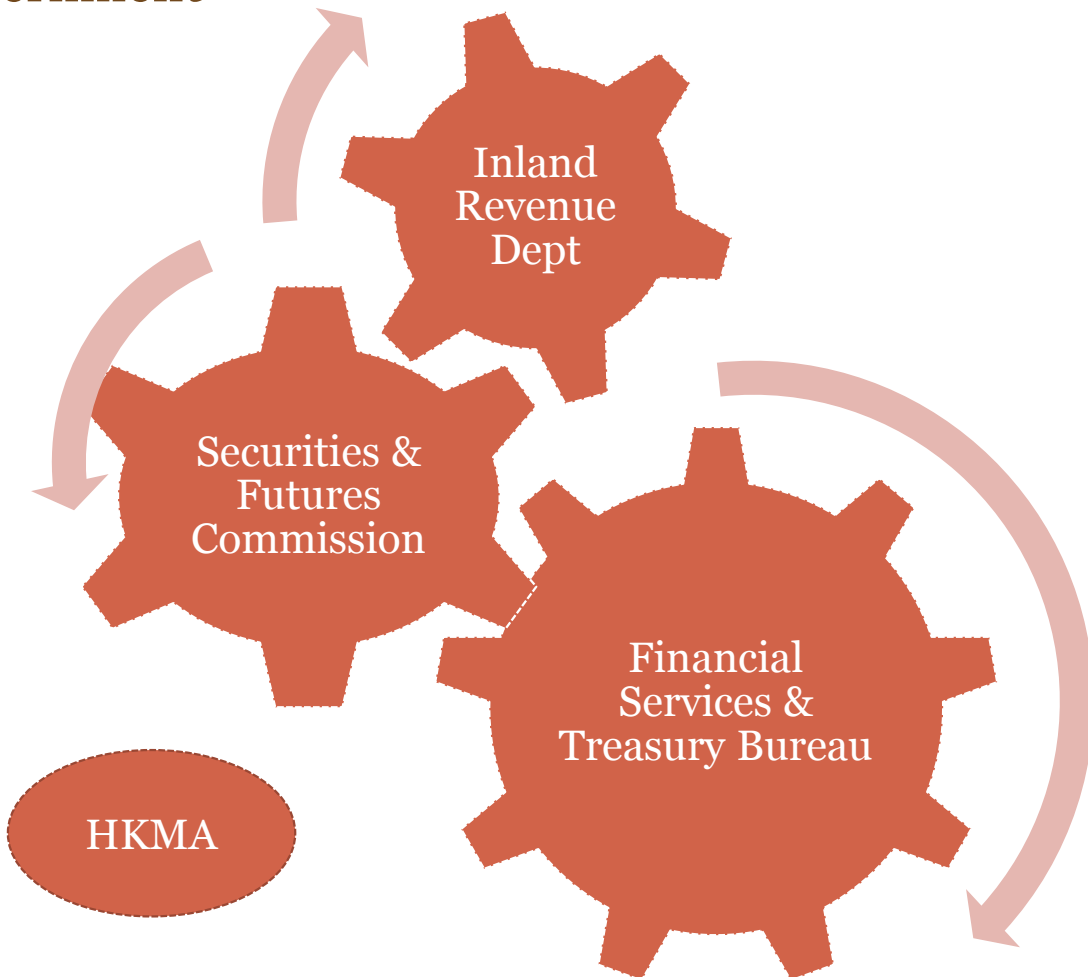


Ability to  
influence

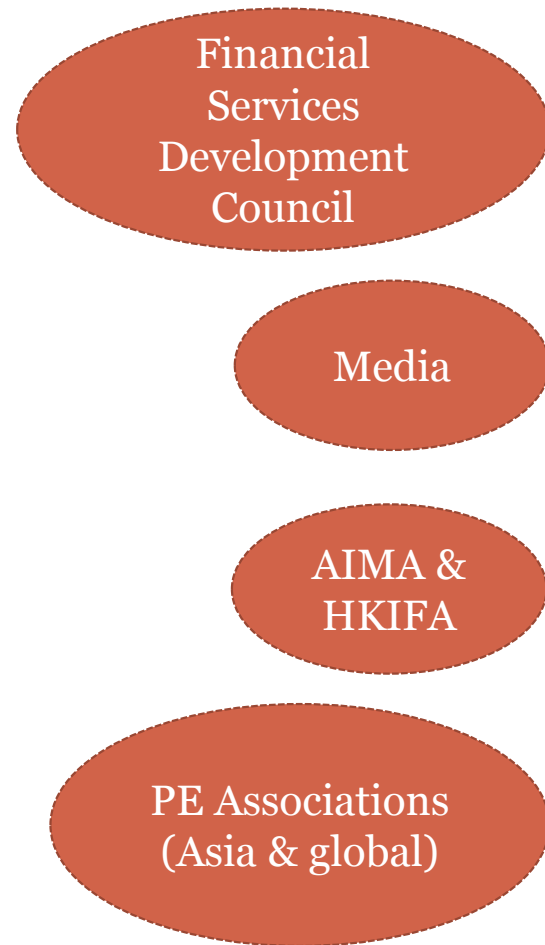


# Who we are talking to...

## Government



## Private sector



# Financial Services & Treasury Bureau



- Despite representing only some 3,000 employees in PE firms in HK
  - PE is an important industry, where HK is the leading hub in Asia
- Tax & legal structures **drive** large parts of PE activities offshore
- DTA's apply only where there is substance...
- Threat from Singapore
  - Opportunity from Mainland China firms
- Need for reform
  - Reform has to address tax, legal & regulatory
  - FSTB understands that 'fund management' needs support to remain competitive

# SFC



## Issues discussed with SFC:

- Should the SFC regulate Private Equity at all...
- Variable application of Type 1, Type 4 and Type 9 licenses
- Examinations for RO applicants: wrong topic & inappropriate(?)
- Monitoring of PE activity: FRR & inspections
- 'Type 16' category for PE firms ??
- Registration – for Offshore Funds Tax Exemption

# IRD

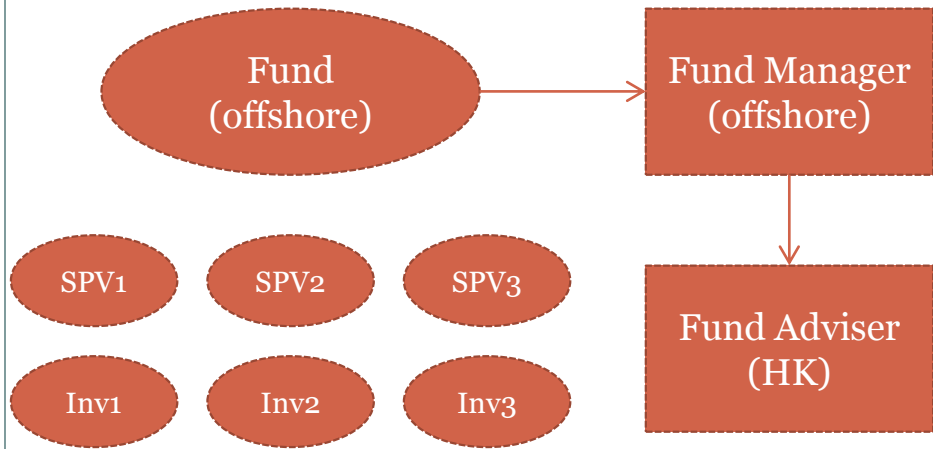


- Implementation of Offshore Funds Tax Exemption
- Inclusion of HK SPVs
- Benefit of China-Hong Kong Double Tax Treaty to HK-based investment vehicles
- Capital Gains Tax
- Transfer pricing: fees from (offshore) Manager to (HK) Advisor
- Carried Interest – taxation
- Onshore funds – central management & control: not in HK...
- Singapore structures

# Current issues...



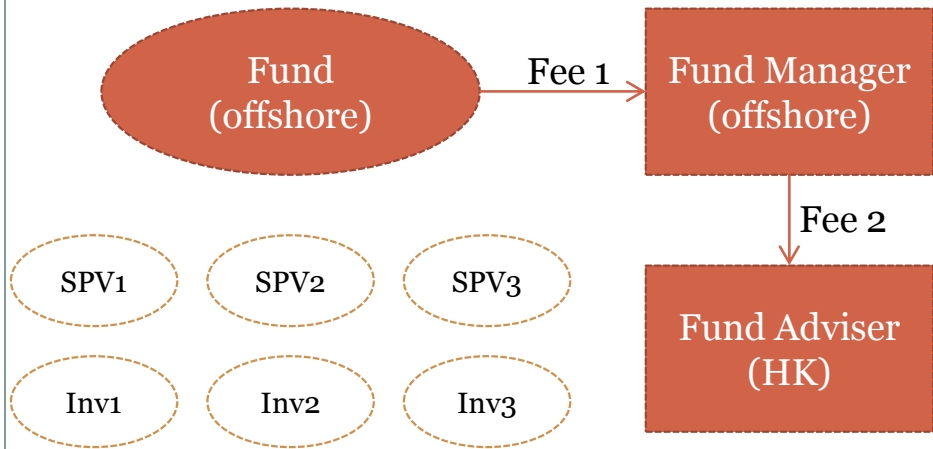
# Offshore Funds Tax Exemption



Currently, ‘Managing’ an offshore Fund from HK could cause the Fund to come onshore for tax purposes...

- Managers of funds making listed investments (mutual funds & hedge funds) have an exemption saying that ‘managing’ from HK will not impact the Fund’s taxation
- 2013 Budget announced this will be extended to ‘private company investments’
- ‘Easy’ solution (non-legislative) is to use existing law – where only SFC licensed entities will qualify
- HK SPV’s will benefit from this change

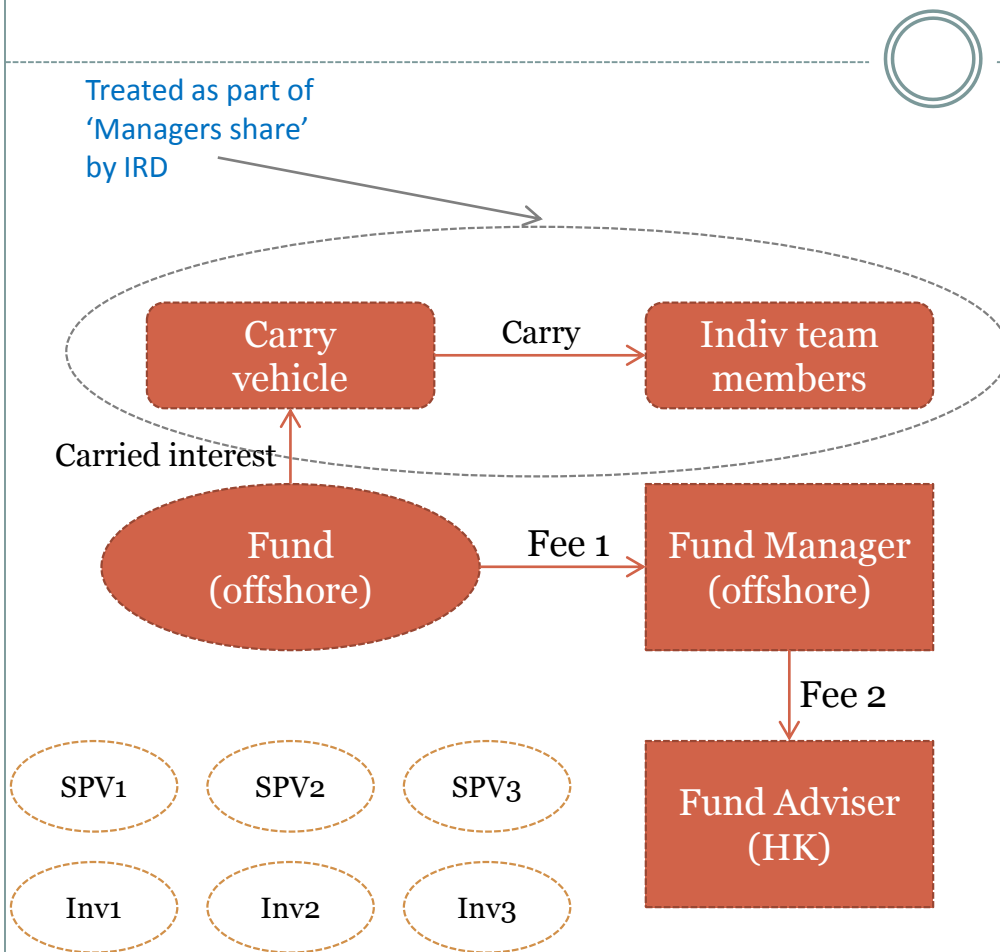
# IRD: Transfer pricing on fees



A couple of years ago, a CEO of an Alternatives firm wrote to the Financial Secretary asking how to apportion 'Advisory Fees'

- IRD asked to comment: 'cost plus' is inappropriate & OECD transfer pricing principles should be applied
- Result was 20-30 investigations & some large retrospective tax claims plus penalties (perhaps more focus on hedge funds)
- Anyone still relying on 'cost plus' for Advisory fee should be very careful
- Tax specialists recommend a more complex analysis & apportionment of activities...

# IRD: tax on carried interest

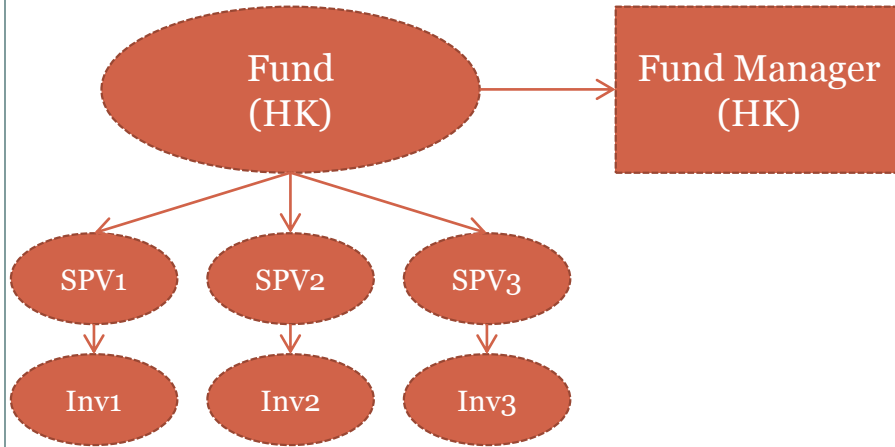


In looking at 'fees' paid from the 'Fund' to its 'Manager' – IRD has concluded that the 'Fee' = '2 + 20' and plans to collect the HK portion of tax on this...

- Note on structure: there are many 'carried interest' structures being employed. Some of these are 'deferred compensation', some have been carefully structured to provide capital gains to individuals.
- There have been a number of IRD investigations of Alternative firms – a number have 'settled' (and reports are that settlement was not expensive)
- IRD indicates that this will be more widely applied in future...



# HK as a fund hub



## Essentials:

- Tax transparency of HK Fund
- Clarity, certainty & consistency of tax for Manager (HK) & team members
- Double Tax Agreements with key investment destinations

## Issues:

- Regulation – SFC obligation...
- Limited Partnership law – needs upgrading
- Tax: profits tax of Manager (cf Singapore), stamp duty...
- Tax: carried interest

# Technical Committee - summary



- Industry / professional advisors: pooled resource to
  - create awareness of new technical issues
  - formulate responses / proposals for changes
  - communicate with members and external parties
- Membership a balance between PE firms & professional advisors
  - will use sub-groups to address specific issues / topics in detail
- Essential that we have a two-way flow of information with HKVCA Members