

Kenneth Hui
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Dear Kenneth,

Comments on the Guidelines for the Certification of Funds

HKVCA appreciates the Monetary Authority's continuous support for the private equity and venture capital industry through initiating several favorable policies. We believe the purpose of such efforts and offering the tax concession for carried interest is to position Hong Kong as a leading PE hub in the world. Therefore, it is of paramount importance that such policies can be practically implemented for them to have the desired effect.

After reviewing the draft Guidelines for certification, we believe the proposed process has a number of issues in which could discourage potential applicants from taking part in the concession program. We would like to outline some immediate industry concerns below for your consideration.

Overall Approach of the "Certification" Process

The industry expects the Government to adopt a light touch approach on the certification process. For instance, upon filing of the profits tax return of either the Hong Kong manager or investment advisor, or the Employer's return, there may be a new disclosure requirement to confirm if the recipient was in receipt of any qualifying carried interest. This is a usual approach for other concessionary tax treatments in Hong Kong, which the current proposed certification process deviates from.

The Disclosure Requirements

Based on the feedback we have received from the industry, we understand that many will be reluctant to make use of the concession based on the level of detail of disclosure currently requested.

In line with our previous understanding of the Bill, we believe that HKMA should be able to determine whether a fund would qualify by review of a fund's private placement memorandum (PPM). Detailed

breakdown of the portfolio, specific entity and personnel information should not be required to certify a fund.

Specifically, around the disclosure of the portfolio companies:

Type A Form: Intention of such form is only to register the fund with HKMA on a light touch basis and hence details of the underlying investments should not be required.

Type B Form: A fund (especially global funds) may have hundreds of investments and details of the portfolio are highly sensitive and confidential from a commercial perspective.

In requesting for such types of information, fund managers will be put in a position to have to decide to disclose confidential information to obtain personal tax concession for their team members against adhering to confidentiality agreements with their investors in their fiducial position as manager of the funds.

At the time that carried interest is earned, it should be the fund manager's responsibility to report according to the law. In addition, it should form part of the auditors' opinion as to whether the relevant conditions, including investments that gave rise to carried interest qualified for the concession, have been met. Ultimately, if the IRD has any queries or wanted to initiate a tax review process, the prevailing IRO already gives the IRD the rights to request for such details.

In addition, in the explanatory memorandum for the Bill, the opinion from the auditors should be kept by the fund manager to be provided if requested by the IRD or HKMA. The Guidelines now require submission to the HKMA.

The IRD's Involvement

It has always been our understanding that the certification process was going to be managed by HKMA and would not involve an assessment from the IRD. IRD involvement at certification stage was not contemplated in the Bill and there was also no mention of it in the accompany explanatory memorandum. The Guidelines seem to deviate from that understanding.

Moreover, the Guidelines require the fund vehicle itself to report its details to the IRD, which would likely not be welcomed by LPs, in particular in relation to offshore funds.

The IRD should only be concerned whether a recipient of carry in Hong Kong qualifies for the concessionary treatment. This is something that the IRD can review, if it chose to, upon filing of the recipient's tax return in Hong Kong.

We believe the additional involvement and information requested by IRD in the Guidelines is contrary to what has already been communicated to the industry and would send a wrong message of IRD's intention to be a heavy hand, and further deter potential applicants.

Timeframe of Submitting Forms

Type A Form: As the intention of Type A Form is only to register the fund with HKMA on a voluntary basis, we do not see any necessity to set a timeframe for submitting Type A Form. Suggest to remove.

Type B Form: Similarly, we assume there should be no prescribed timeframe for submission of Type B Form. If a timeframe must be added, the Government may consider following the same due date for filing of a Hong Kong profits tax return by a qualifying person.

Requirement to Route Carried Interest Payments through a Qualifying Person

It is practically very difficult to distribute carried interest to qualifying employees through a qualifying person in Hong Kong. If the legislation requires a qualifying person to recognise carried interest from a P&L perspective, it will cause significant concerns from commercial and regulatory perspectives (FRR requirements, inconsistent with global pool arrangement, investors' consents, etc.).

The Government may wish to explore alternative ways such as amending the Hong Kong profits tax return to add a box (or a supplementary form) for disclosure of carried interest being distributed by relevant offshore vehicles to qualifying employees, etc.

Also, currently, an employee can be chargeable to tax on compensation paid by an overseas associate of his employer. The Employer's Return includes a section to report such income. We believe the existing forms and procedures should be sufficient to satisfy the reporting requirements of the concession.

Conclusion

The legislation of HKLPF and Concession Tax for Carried Interest is encouraged, however, an impractical application process could jeopardize the efforts the government has made to date. Anything less than something workable for the industry could potentially impact HK's efforts in trying to position it as an international fund domicile. The credibility issue may also impede the development of other regimes, such as the private OFC.

After soliciting feedback from our members, we strongly believe that the disclosure requirements, the assessment from IRD and the requirement to recognize carried interest paid to qualifying employees in the P&L of the qualifying person would be extremely difficult for industry practitioners to follow. We recommend HKMA to be the sole agency involved in certifying the fund, adopt the PPM as the only evidence in the process, and rely on existing tax reporting and audit frameworks for application of the concession.

We are at your disposal should you wish to discuss further as you finalize the Guidelines.



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The Association for Private Capital in Asia

Finally, we append to this letter the results of our member's survey for the questions you had posed. We hope you find this data helpful in your decision making.

Yours sincerely,

Bonnie Lo

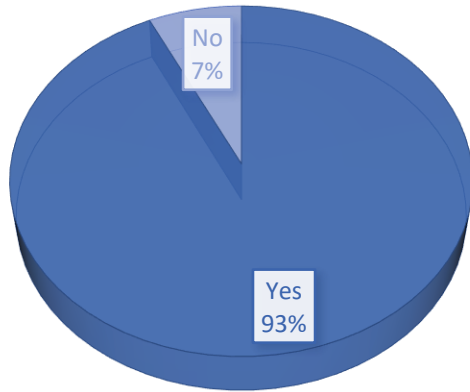
Chair, HKVCA Technical Committee

About HKVCA

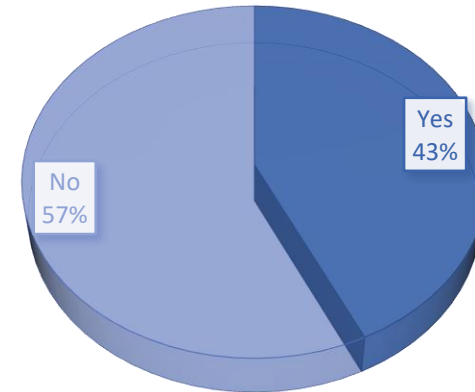
HKVCA is a member-based trade association which was established in Hong Kong in 1987. It currently has 480 members of whom 300 are Hong Kong based private equity managers across the full spectrum of the industry from venture capital, through growth capital and growth buyouts to institutional fund investors, fund of funds and secondary investors. HKVCA represents small teams investing in start-ups as well as the world's 10 largest private equity firms.

Appendix: HKVCA Members Survey

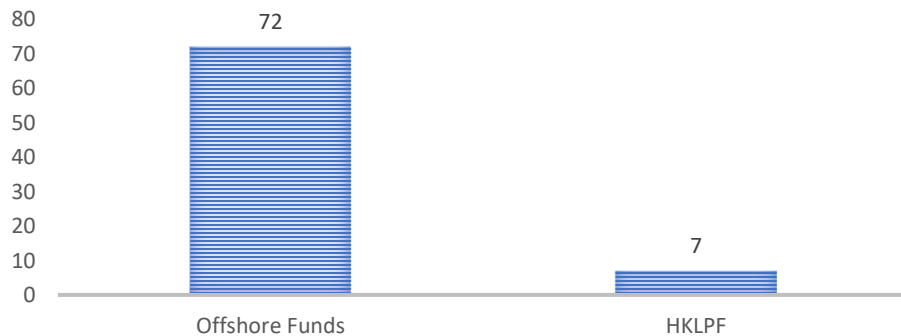
IS YOUR FIRM INTERESTED IN CLAIMING CARRIED INTEREST TAX CONCESSION?



IS YOUR FIRM INTERESTED IN CLAIMING IN THE YEAR OF ASSESSMENT 2020/21?



AGGREGATED NUMBER OF FUNDS THAT HKVCA RESPONDENTS WOULD BE INTERESTED IN APPLYING CARRIED INTEREST CONCESSION



PREFERENCE OF APPLYING THE CERTIFICATE BY HKMA BEFORE OR AFTER THE DISTRIBUTION OF CARRIED INTEREST?

