Hong Kong Venture Capital and Private Equity Association
香港創業及私募投資協會

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Ms Salina Yan
Financial Services & Treasury Bureau
24/F Central Government Offices
2 Tim Mei Av, Tamar
Hong Kong

Offshore Funds Tax Exemption
Response to FSTB Consultation Legislative Proposal

Dear Salina

We would like to thank you for this opportunity to add further comments to a process which has already benefitted from your openness to dialogue on the optimal way to include private equity activities in the Offshore Funds Tax Exemption legislation.

We are very appreciative of the Legislative Proposal, recently circulated, including wording to respond to industry concerns that the changes to the legislation be available to (i) unlicensed private equity managers/advisors and (ii) SPVs used by Funds as part of investment structures.

At the meeting you arranged last week, there was useful feedback from industry practitioners to which we add a few comments below. As always, the detailed wording is extremely important in the final version – and we hope that the legislative proposal will reflect:

1. That SPVs are used in a variety of ways and sometimes in several layers where there may be multiple owners at one or more levels – and this should not jeopardise the SPV's status

2. In Annex C the definition of SPV para (b) states "is established solely for the purpose of holding, directly or indirectly, an excepted private company". There is a small problem with the use of "solely for the purpose of holding" because the Offshore Fund will want the SPV to have some activities that provide 'substance' for the SPV to be treated as tax resident in HK. Could the wording of clause (b) be amended to "is established solely for the purpose of holding, directly or indirectly, and monitoring an excepted private company"

Room 2001, Wilson House, 19-27 Wyndham Street, Hong Kong
香港中環雲咸街 19-27 號威信大廈 2001 室
www.hkvca.com.hk
Tel: 852 2167 7518
Fax: 852 2167 5730

HK私投募資VCA

3. An 'excepted private company' by the current definition cannot have a HK subsidiary. Since we invest Asian businesses, it is quite possible that an investee will have an interest in the HK market and may have a HK subsidiary for this activity. It appears to us that this is less sensitive for HK tax (since the HK subsidiary will pay tax on any profits it makes in HK) than property ownership. Could this requirement by qualified in a way (similar to the de minimis clause relating to property) that only disqualifies investments in companies that obtain more than 10% of their consolidated profits from a HK subsidiary.

4. An Offshore Fund either investing directly, or investing through an SPV, may choose to invest in a HK operating entity – and in these circumstances the offshore nature of the Offshore Fund should not be tainted. The HK operating investment should be assessable for HK tax to the extent required by law, but the Offshore Fund should remain covered by the Offshore Funds Tax Exemption.

5. Bona fide private equity funds take many different forms – and the definition should include sovereign wealth funds, state owned enterprises, pension funds and listed private equity vehicles that may be funded by one, or less than five, capital providers or investors, with a 'captive' manager/advisor – but which should be considered 'bona fide' for this legislation.

6. For the sake of clarity, it would be helpful to highlight that the 'deeming' provision for a 'bona fide widely held' fund for this new PE fund tax exemption will take the 'more than 5 investors' per 'qualifying fund' as the definition rather than the 'more than 50 investors' in the current S 20AE.

7. Certain smaller funds (such as venture capital funds) may have individuals in the manager who have contributed more than 10% of the capital in the Fund.

8. The concept of 'look through' of various layers of structuring (which are often employed to co-mingle multiple parties which have different regulatory or governance requirements) is essential so that the 'ultimate investors' are taken into account when assessing a 'qualifying fund'.

We hope these suggestions can be incorporated into the final wording – as we believe they do not jeopardise the intentions behind the new legislation – but will make it considerably more useful for industry practitioners.

Yours sincerely

John Levack
Vice Chairman