

Reforms in Hong Kong Encourage Homecoming of Offshore Funds


Hong Kong is one of the largest fund management hubs in Asia, with HKD34.9 trillion worth of assets under management by the end of 2020. ^[1] Many investment funds offered in Hong Kong were incorporated in offshore jurisdictions such as the Cayman Islands and the British Virgin Islands (BVI) as either segregated portfolio companies (SPCs) or limited partnerships (LPs).

Since 2018, the Hong Kong government has taken steps to reform the investment funds regime in Hong Kong by introducing new structures and incentive schemes. These initiatives concurred with the economic-substance laws addressing cross-border tax avoidance and anti-money laundering issues in popular offshore jurisdictions, which made it more costly to set up and maintain funds offshore and may encourage funds to consider re-domiciling in Hong Kong.

Set out below are the key incentive schemes as well as an overview of the new fund structures in Hong Kong, namely the open-ended fund company (OFC) regime and the limited-partnership fund (LPF) regime.

Re-Domiciliation of Funds

In July 2021, the Hong Kong government gazetted a fund re-domiciliation mechanism to encourage offshore funds set up in corporate or limited-partnership form to register in Hong Kong as OFCs and LPFs, respectively. This mechanism does not create any new legal entity; therefore, it does not require the dissolution of the original funds or require investors to exchange their interests from the old fund to the new fund. Upon re-domiciliation, these



funds would be de-registered in the original place of incorporation and would have the same rights and obligations as any other newly established OFCs and LPFs in Hong Kong.

If approved by the Legislative Council, this re-domiciliation mechanism is expected to come into operation in late 2021.

OFC Grant Scheme

Officially launched in May 2021, the grant scheme for open-ended fund companies (OFC Grant Scheme) was announced as an initiative to strengthen Hong Kong's position as a major international fund-management center. The OFC Grant Scheme, operating from May 2021 to May 2024 (or until the initial funding is fully committed), aims to subsidize investment managers that have successfully incorporated an OFC or re domiciled a non-Hong Kong fund corporation for 70% of the eligible expenses paid to Hong Kong-based service providers, capped at HKD1 million per OFC.

Zero Tax on Carried Interest

In May 2021, Hong Kong amended the Inland Revenue Ordinance and introduced a tax concession scheme that provides for a tax rate of 0% for eligible carried interest. To be eligible for the scheme, the carried interest must be received by a qualifying person ^[2] by way of profit-related return from investment management services that the person provides for a certified investment fund. To become certified, an investment fund must apply to the Hong Kong Monetary Authority (HKMA) and demonstrate that (1) the fund has made private equity (PE) investments and (2) the carried-interest recipient has two or more full-time employees who are qualified to carry out investment management services and has incurred HKD2 million or more in operating expenditure in Hong Kong. Investment funds that are nonresident in Hong Kong must appoint an authorized representative when applying to HKMA for

certification.

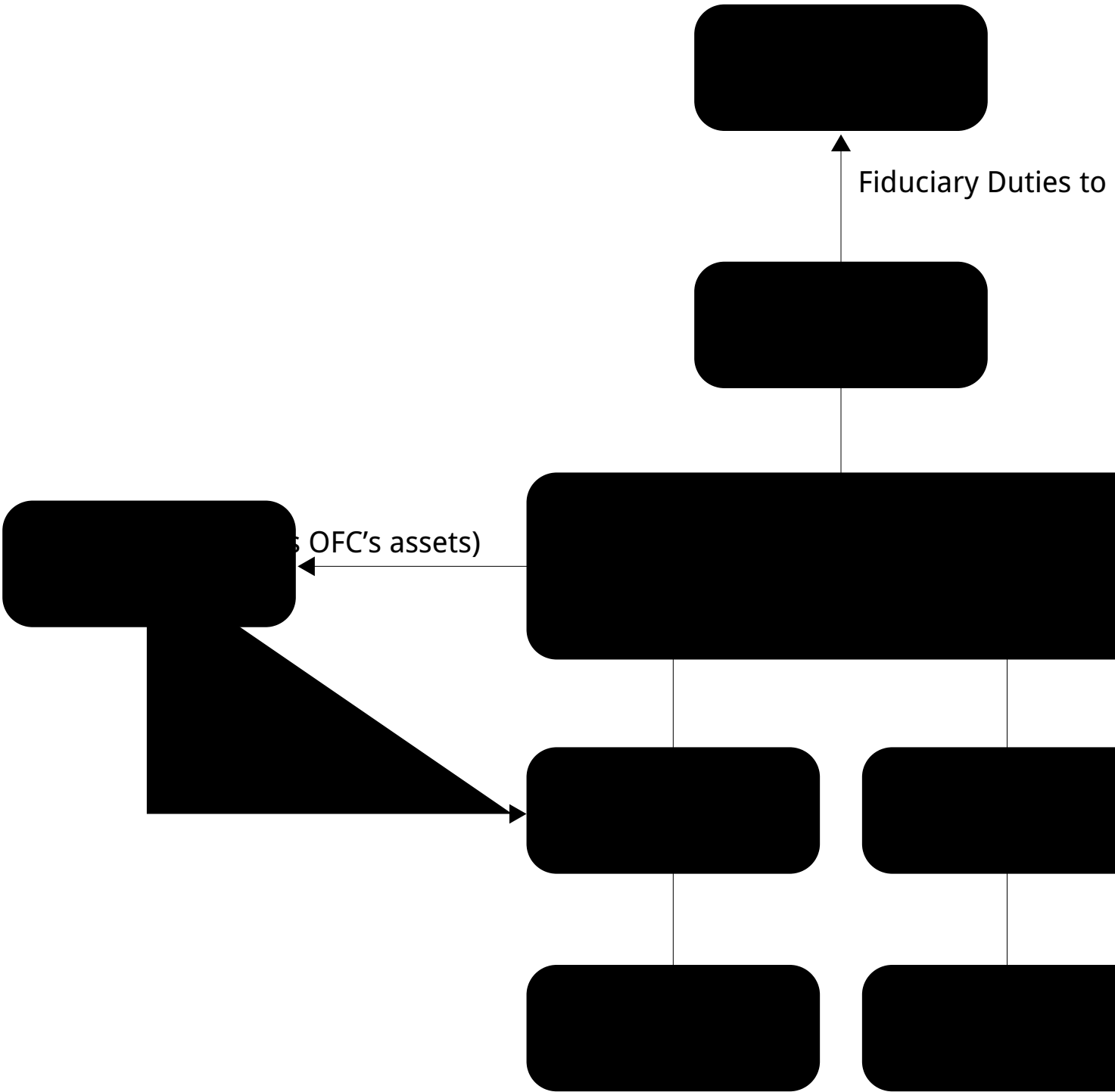
Wealth Connect and Mutual Recognition of Funds

Over the years, Hong Kong and mainland China have jointly launched several cross-border investment schemes to enhance the link between the two markets. The Wealth Connect, which formally commenced trading on September 10, 2021, allows Hong Kong-domiciled funds to be offered to mainland Chinese investors in the Guangdong-Hong Kong-Macao Greater Bay Area. This adds to the Mutual Recognition of Funds scheme, which started in 2015, allowing Hong Kong-domiciled funds to be distributed in mainland China. These connect schemes serve as another incentive to encourage fund managers to re domicile offshore funds to Hong Kong.

The availability of OFC and LPF structures in Hong Kong provides for the popular corporate forms that many offshore investment funds currently adopt. These structures, along with the above incentive schemes, offer fund managers a compelling reason to consider setting up and moving their funds onshore.

The Open-Ended-Fund-Company Regime

In July 2018, the OFC regime came into operation in Hong Kong under the Securities and Futures Ordinance. An OFC has variable share capital, giving investors the flexibility to subscribe to or redeem their investment without shareholders' approval. It offers limited liability to investors and allows for the operation of one or more sub-funds. Such a sub-fund is legally separate from the assets and liabilities of the other sub-funds under the same OFC, making the OFC structure a popular choice for multi-class funds, umbrella funds, and master-feeder structures. Such segregated liability between sub-funds is similar to that in an SPC in the Cayman Islands and the BVI.



Application

A single application for the following must be made to the Securities and Futures Commission (SFC):

1. the registration of the OFC by the SFC;
2. incorporation by the Companies Registry; and
3. business registration with the Inland Revenue Department (IRD).

Fund Requirements

An OFC must appoint the following parties:

- Directors: There must be at least two directors who are natural persons and at least one independent director who is not a director or employee of the custodian.
- Investment manager: An OFC must appoint an investment manager that is licensed for SFC Type 9 regulated activity.
- Custodian: A custodian, either eligible under the Unit Trust Code for SFC-authorized funds or licensed for Type 1 regulated activity, must be appointed to hold the fund property in its custody.

Other requirements include:

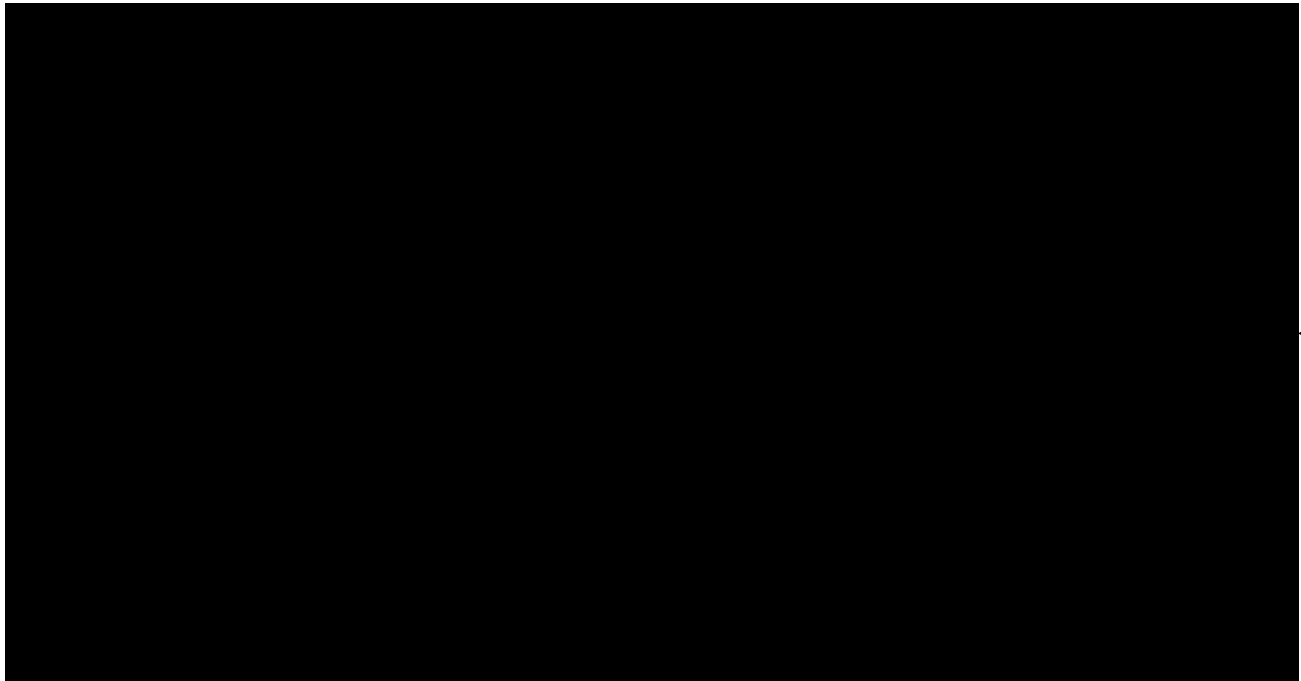
- an instrument of incorporation, which is equivalent to the articles of association for a limited company;
- an offering document that serves to invite offers to subscribe for shares of the OFC in compliance with the disclosure requirements in the Code on open-ended fund companies; and
- regular corporate filings regarding any material changes to the OFC, along with an audited annual report for each financial year.

The Limited-Partnership-Fund Regime

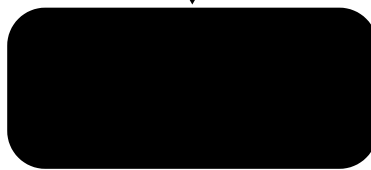
The LPF structure was introduced under the Limited Partnership Fund Ordinance in August 2020. It is constituted by a limited-partnership agreement between at least one general partner (GP) and one or more limited partners (LPs).

An LPF is a closed-ended fund that does not have separate legal personality. The GP is responsible for the management and control of the fund and is imposed with unlimited liability for the debts of the fund. As investors, the LPs do not take part in the management of the fund; however, they are allowed to participate in certain affairs, such as taking part in the appointment and removal of a GP or an LP.

Using an LPF structure offers the freedom of contract in relation to the operation of the fund, as many matters can be built into the limited-partnership agreement. Such matters include the admission and withdrawal of partners, transfer of interests, investment scope and strategy, rights and obligations of the partners, and dissolution procedures. Since an LPF does not have separate legal personality, another advantage is that its profit is not subject to corporate tax. Tax is levied only on the share of an LP's income from the LPF according to each LP's individual tax position.



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Application

Application to register an LPF shall be made to the Companies Registry by the GP. It typically takes four working days for a certificate to be issued. The GP must apply for business registration with the Business Registration Office and the IRD within one month after the registration date.

Fund Requirements

An LPF must appoint the following parties:

- GP: If the GP is another LPF or a non-Hong Kong limited partnership, the GP must appoint an authorized



representative (AR) to be responsible for the management and control of the LPF. If an LPF has an AR, the GP and AR are then jointly and severally liable for all the debts and obligations of the LPF. While an LP is not required to appoint a custodian separately, the GP has the obligation to ensure the proper custody of the assets of the LPF. To limit the impact of potential unlimited liability, the GP is often a special-purpose vehicle.

- LP: The LPF must have at least one LP, which could be either an individual, a corporation, or a partnership.
- Investment Manager: The GP must appoint an investment manager, typically a different legal entity, to carry out the day-to-day investment management functions of the LPF. There is no requirement that the investment manager be licensed by the SFC if the LPF will not carry on a business of regulated activities in Hong Kong.
- Responsible Person: The GP is required to appoint a responsible officer (RO) to comply with the obligations under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance. This RO must be either an authorized institution, a licensed corporation, an accounting professional, or a Hong Kong or a foreign registered lawyer.

An LPF is obligated to file an annual return to the Companies Registry. Filings must also be made to the Companies Registry regarding any material changes to the LPF – e.g., change of GP, AR, or investment manager.

For more information about the fund market in Hong Kong, please contact corporate partner David Cheng or your usual contact at Winston.

^[1] Financial Services Development Council, Hong Kong: Asset Management Centre for Global Investors, <https://www.fsdcc.org.hk/en/media/hong-kong-asset-management-centre-for-global-investors>.

^[2] “Qualifying person” as defined under Section 4(3) of Schedule 16D of the Inland Revenue Ordinance.



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