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Hong Kong limited partnership fund bill: Introduction of limited partnership regime for funds

Hong Kong long-awaited limited partnership regime for funds (LPF Regime) designed for private funds is expected to arrive later this year. Following with Hong Kong's 2020-21 budget speech in February 2020, the Hong Kong government has gazetted the Limited Partnership Fund Bill on 20 March 2020 specifically for funds. The bill is now subject to legislature procedures and expected to come into operation on 31 August 2020. During the budget speech, the government also stated that it is also planning to provide tax concessions for carried interest issued by private equity funds operating in Hong Kong, subject to the fulfilment of certain conditions, which once enacted, should hopefully help address the concern that the taxation of carried interest in Hong Kong has been a contentious issue for long.

Together with the already enacted unified Hong Kong tax exemption regime for funds (which provides Hong Kong tax exemption to all funds provided conditions are satisfied), the new LPF regime will not only attract more funds to Hong Kong and accelerate the development of such private funds, it can also drive up demand for capital, talent and expertise into different sectors including technology and professional services taking advantage of the tremendous business opportunities inherent to the Greater Bay Area.

What are the current options for funds establishment in Hong Kong and why is Hong Kong's existing limited partnership ordinance not sufficient?

Currently, funds are mainly established in Hong Kong in the form of unit trusts or open-ended fund companies ("OFC")[1] , however, not all overseas fund managers are familiar with the Hong Kong's trust law or OFC regime. Instead it is much more common for fund managers to establish their fund, especially private equity ("PE") funds via general partner/limited partner structures based in offshore jurisdictions such as Cayman Islands where they have the relevant Exempted Limited Partnership law tailored for funds.

Hong Kong's own Limited Partnerships Ordinance (Cap. 37) was enacted a century ago, and is typically used to establish professional practices such as accountancy, law, etc., rather than meeting the needs of the funds industry. The existing ordinance possesses less flexibility in governing matters pertaining to capital contributions and the distribution of profits. It currently cannot suit the operational needs that fund managers require, such as variable share capital arrangements to meet investors' ad hoc subscription and redemption requests, or streamlined procedures for termination. As a result, fund managers often hesitate to establish funds in Hong Kong. Differences in tax treatments is another common consideration, but this falls outside the scope of discussion for this article.

What are the opportunities open to Hong Kong with the introduction of the LPF Regime?

In the backdrop of the global regulatory landscape for the fund industry, the Organisation for Economic Co-operation and Development ("OECD") introduced Base Erosion and Profit Shifting ("BEPS") over 135 countries including Cayman Islands to combat tax avoidance with the concept of "economic substance" test. Accordingly, fund managers who are used to establishing their funds in offshore jurisdictions without "economic substance" are now potentially subject to regulatory challenge, and may eventually need to demonstrate this, perhaps with the maintenance physical presence (e.g. office), or the hiring of full time employees in the offshore jurisdictions in which they are situated. It is also the trend that such requirements might be further tightened in the future. Taken together, these push factors may lead fund managers around the world to revisit their fund structures, and consider moving their funds and business activities back onshore.

[1] The new opened-end fund company ("OFC") regime was introduced to Hong Kong in July 2018. Below is the FAQs of OFC provided by Financial Services and The Treasury Bureau: https://www.fstb.gov.hk/fsb/ppr/consult/doc/ofc_faq_e.pdf

Meanwhile, in February 2020, the Cayman Islands has been added to the European Union ("EU")'s blacklist of non-cooperative jurisdictions, which means that the Cayman Islands may be subject to additional administrative or defensive measures imposed by the EU member states. This could be another push factor for industry players to consider re-domiciling their funds.

The new LPF regime is poised to play a key role in attracting fund managers, especially those based in Asia, to consider establishing new funds or re-domiciling their existing funds in Hong Kong.

What are the key features of the proposed LPF regime?

1. **Constitution of an LPF:** at least two partners (one general and one limited), under a written agreement such as a limited partnership agreement.

   General Partner: either an individual, a Hong Kong private company limited, a non-Hong Kong company registered with Hong Kong's Company Registry or a domestic/offshore's limited partnership.

   Limited Partner: either an individual, a corporation, a partnership, a trustee, an unincorporated body or any other entity or body.

2. **Legal liability:** In line with prevailing overseas practices, LPF itself is not a legal person. The general partner of an LPF has unlimited liability with respect to the debts and liabilities of the fund, as well as ultimate responsibility for the management and control of the fund. On the other hand, the liability of limited partner(s) of an LPF will generally be limited to the commitment they make to the fund, and will not have day-to-day management rights or control over the underlying assets held by the LPF.

3. **Registration:** LPF shall maintain a registered office in Hong Kong. The application must be submitted by a "presentor", either a registered Hong Kong law firm or a solicitor admitted to practice Law in Hong Kong. The application shall be submitted to Hong Kong's Registrar of Companies.

4. **Appointment of Investment Manager, Auditors and Responsible Person:** LPF must appoint either a Hong Kong resident over 18 years old or a corporation registered in Hong Kong as investment manager, as well as a local auditor to perform annual audits of financial statements, and a responsible person (e.g. an authorized institution, a licensed corporation, an accounting professional or a legal professional) to carry out LPF's AML/CTF function.

5. **Migration of funds:** A streamlined channel will be provided to existing funds registered under the Hong Kong's Limited Partnership Ordinance (Cap. 37) to migrate onto LPF regime.

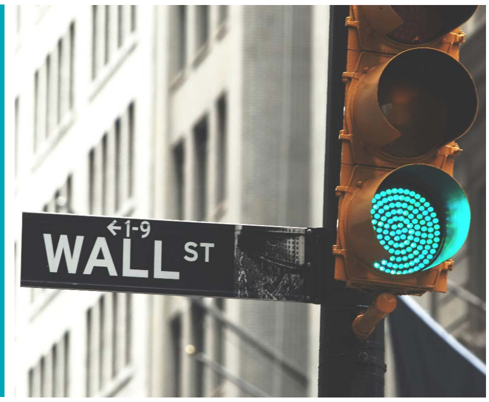
6. **Confidentiality of Limited Partners:** The identity of the limited partnership would NOT be accessible on public registers for the sake of confidentiality. The relevant records should still be kept at the registered office or any other place in Hong Kong known to Hong Kong's Registrar of Companies and accessible by law enforcement officers when necessary.

7. **Tax and Stamp Duty Treatment:** LPF can enjoy profit tax exemption provided that it meets certain exemption conditions set out under Unified Funds Exemption regime. As for stamp duty, an interest in LPF is not a "stock" and is not chargeable with stamp duty when the interested is contributed, transferred or withdrawn.

What is the next step?

The legislative process of LPF regime is expected to complete in year 2020 and hopefully it can commence on 31 August 2020 as scheduled.

We anticipate significant long-term benefits from the establishment of this new regime, by shoring up Hong Kong's competitive edge in the global asset and wealth management industry, and further develop the growth of the private equity and family offices industries. We will share with you more of our insights and perspectives as and when future developments occur.



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