

Insights

HONG KONG: THE LIMITED PARTNERSHIP FUND REGIME FOR PRIVATE EQUITY REAL ESTATE FUNDS AND OTHER PRIVATE EQUITY FUNDS

Jun 24, 2020

Introduction

Hong Kong has taken a further step towards establishing itself as a leading fund formation jurisdiction with the passing of the Limited Partnership Fund Ordinance (Cap. 637), effective 31 August 2020, to provide for the registration of limited partnership funds (“LPFs”) governed by Hong Kong law. This has been welcomed by managers of private equity funds based in Hong Kong and those based in Mainland China (in the latter case, for those managing inbound investments financed by international investors via an offshore fund structure).

Many private equity fund managers are applying to register LPFs and others are in the process of considering the pros and cons of domiciling their existing private equity fund platforms under the LPF regime. Amendments to the Inland Revenue Ordinance (Cap. 112, the “IRO”) to give effect to a tax concession regime for carried interest derived from investment management services rendered in Hong Kong, subject to a validation scheme operated by the Hong Kong Monetary Authority, with retrospective effect from the tax year beginning 1 April 2020, are in progress.

Characteristics of Limited Partnership Funds under Hong Kong Law

An LPF is a managed investment scheme in the form of a limited partnership being an arrangement under which contributions of the participating persons, and the profits or income from which payments are made to them, are pooled. An LPF must have:-

- (a) at least one limited partner contributing capital - with no liability for the debts of the partnership provided that its management input is limited to the 18 permitted activities in Schedule 2 which are not regarded as management of the LPF;
- (b) a general partner with ultimate management responsibility and unlimited liability for the debts of the partnership;
- (c) an investment manager (appointed by the general partner) for day-to-day investment management functions;
- (d) a custodian of the LPF’s assets or other proper custody arrangements;

- (e) a registered office in Hong Kong;
- (f) an independent auditor (appointed by the general partner); and
- (g) a responsible person (appointed by the general partner) to carry out measures to minimise the risks of money laundering and terrorist financing.

The LPF regime expressly provides for “contractual freedom” among partners to decide issues such as the admission of new partners, the rights and obligations of partners, transfers of partnership interests, the waterfall for distributions (subject to a solvency test) to partners and the organisation and governance of the LPF.

An LPF will qualify for the “unified funds exemption” from Hong Kong profits tax if it meets the definition of a “fund” under section 20AM of the IRO, as more fully explained in the Inland Revenue Department Interpretation and Practice Note No.61 (June 2020). Any holding company or special purpose vehicles established by the general partner are expected to apply for Hong Kong tax residence certificates to enjoy the reduced rates of tax from treaties in jurisdictions where investments are made. A limited partnership interest will not be “stock” and therefore will not be subject to stamp duty when the limited partnership interest is subscribed or transferred.

Limited partners are permitted to conduct certain “Schedule 2” activities without being considered as managing the LPF. These activities include serving on a board or investment committee of the LPF, taking part in a decision of admission or withdrawal of a partner and advising or approving the general partner or investment manager on business, accounts, valuations.

Partners of an LPF may agree in the limited partnership agreement the conditions and procedures for the voluntary dissolution of the LPF. After the LPF is dissolved, the general partner must file a notification with the Registrar of Companies within a specified time. The LPF regime also provides for dissolution of the LPF on application to the court by a partner or creditor of the LPF on certain grounds, such as the business of the LPF can only be carried on at a loss or a partner in the LPF (other than the applicant) has wilfully or persistently breached the limited partnership agreement, or has conducted themselves in matters relating to the LPF's business such that it is not reasonably practicable for the other partners to carry on the business with that partner.

The LPF regime also provides that an LPF is an unregistered company for the purposes of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32). This means that a partner or creditor may present a winding up petition to the court under the Ordinance, and the LPF may be wound up by the court under certain circumstances, including in a case where the LPF is unable to pay its debts.

Licensing

Any “regulated activities” undertaken by the general partner, the investment committee and the investment manager such as asset management and inducing others to invest when marketing a fund will, unless incidental or exempt, be subject to Hong Kong's licensing regime and related

guidance, most recently in the form of the SFC's 7 January 2020 Circular to private equity firms seeking to be licensed. General partners themselves would not need to be licensed if they have delegated all of their asset management functions to an investment manager which is licensed to carry on such regulated activities.

Members of an investment committee with a 'dominant role' in making investment decisions are required to be licensed but others whose primary role is to provide a legal, compliance or internal control perspective are not required to be licensed.

If the underlying investments of a fund held through SPVs are real estate, the management of such real estate may not require a license as it would fall outside the statutory definition of "asset management" which only applies to real estate investment schemes authorised by the SFC for public offering. However, depending on the facts, active management of the portfolio of SPVs may nevertheless be viewed as "asset management" at the level of the SPVs unless the SPVs are passive or can be structured under the exemption for the management of a portfolio of Hong Kong private companies.

In analysing the licensing issues from a strictly legal perspective one should bear in mind that the inclusion of a licensed and regulated entity in the structure of the fund may appeal to, and may even be an essential requirement for, certain sophisticated investors. In any event, an asset management license will enable direct marketing efforts pursuant to the incidental exemption thereby avoiding the fees of a separate placing agent.

Registration

An application for registration as an LPF under Hong Kong law must be submitted to the Registrar of Companies by a Hong Kong law firm or a solicitor admitted to practise Hong Kong law on behalf of the fund. The general partner must apply for a Business Registration Certificate for the LPF within one month after the registration date (if it does not already hold one at that time). Upon registration, the Registrar of Companies will issue a certificate of registration of the limited partnership fund.

The Registrar of Companies will maintain: (a) an index of the names of all LPFs; and (b) a register that records up-to-date information about each LPF. The LPF Index and the LPF Register will be made available for public inspection. However, the names of the limited partners will not be accessible on those public registers.

As we do not expect any applications to be made for LPFs to be authorised by the SFC as collective investment schemes, registration with the Registrar of Companies will not mean that limited partnership interests in the LPF can be offered to the public. However, even in the absence of such SFC authorisation, there is a safe harbour available to LPFs enabling limited partnership interests to be marketed and privately placed with eligible institutions and high net worth individuals meeting the statutory definition of a 'professional investor'.

Conclusion

With a regulatory framework that now permits a wide range of SFC authorised collective investment schemes available to the public in Hong Kong together with privately placed open-ended fund companies for hedge funds and limited partnerships for closed-end and even open-ended private equity funds governed by and formed under Hong Kong law, Hong Kong is now well placed to emerge as a favoured domicile and location for fund managers relative to alternative offshore and overseas jurisdictions. This is particularly the case when offshore fund structures are currently facing OECD driven challenges from tightening regulatory frameworks such as transfer pricing and economic substance requirements.

RELATED CAPABILITIES

- Corporate
- M&A & Corporate Finance
- Securities & Corporate Governance
- Regulation, Compliance & Advisory
- Business & Commercial Disputes

MEET THE TEAM



Phill Smith

Co-Author, Hong Kong SAR

phill.smith@bclplaw.com

[+852 3143 8452](tel:+85231438452)



Glenn Haley

Hong Kong SAR

glenn.haley@bclplaw.com

[+852 3143 8450](tel:+85231438450)



Andrew MacGeoch

Singapore / Hong Kong SAR

andrew.macgeoch@bclplaw.com

[+65 6571 6625](tel:+6565716625)

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.