



# Asset Management Tax update

## Carried Interest 0% Tax Concession – Hong Kong

29 January 2021

The Government today released the legislation on the concessional tax treatment for carried interest in Hong Kong.

The **eligible carried interest distributions are to be taxed at a 0% rate** for qualifying persons who are subject to profits tax, and for qualifying employees subject to salaries tax

This concession will ensure that Hong Kong remains Asia's leading Private Equity hub in Asia

The Government today released the proposed legislation on the concessional tax treatment for carried interest in Hong Kong.

The Inland revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021 confirms that **eligible carried interest distributions are to be taxed at a 0% rate** for qualifying persons who are subject to profits tax, and for qualifying employees subject to salaries tax.

The concessional tax treatment will apply to eligible carried interest received by or accrued to qualifying carried interest recipients on or after 1 April 2020.

The draft legislation is in line with the proposed framework issued on 31 December 2020 by the task force led by Financial Services and the Treasury Bureau. We are closely analysing the provisions and will share more detailed observations shortly, however, at a glance the provisions provide for the following:

- The framework will apply to carried interest paid by funds that fall within the meaning of "fund" in the UFE, and the 0% rate will apply to distributions paid out of profits from transactions in shares, stocks, debentures, loan stocks, bonds or notes of, or issued by, a private company; or transactions in shares or comparable interests in special purpose entities ("SPEs") or inter-posed SPEs who directly or indirectly hold interests in private companies.

However, the draft legislation appears to restrict eligible carry arising from gains from transactions in SPVs to the extent the SPV only holds shares in a private company.

- Carried interest distributions must be profit related returns, and on the face of it would appear to be able to be paid out of realised, or unrealised profits – provided that hurdle rates of return for limited partners ("LPs") are fulfilled in accordance with the fund's constituent documents.

However, the provisions do refer to a "minimum amount" of carry distributions being subject to "significant risk", otherwise the minimum amount will not be subject to concessional treatment. The draft legislation does not prescribe how to determine what risk is "significant" or how to ascertain the "minimum amount" - although it would appear that this requirement refers to carving out profits comprising guaranteed returns.



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- Minimum substance requirements will need to be met for investment management services provided to the fund and carried out in Hong Kong, namely, at least two full-time qualified employees and a minimum HK\$2 million of annual spend. However, subject to the additional requirement that the Commissioner of Inland Revenue must be satisfied that the number of qualified persons and expenditure is adequate for the fund.
- Anti-avoidance provisions will apply to nullify arrangements which have as their main purpose, or one of the main purposes of recharacterising management fees as concessional taxed carried interest payments. This test appears in line with the multi-lateral instrument “principle purpose test”, and is arguably a lower threshold than the general anti-avoidance provision section 61A of the Inland Revenue Ordinance.
- The legislation also stipulates the need for adequate documentation and enables the IRD to liaise with the Hong Kong Monetary Authority on the application of the tax concession.

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