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Hong Kong wealth management update

There have been a number of recent legal and regulatory changes in Hong Kong that have impact from a wealth management perspective.

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Transfer pricing

On 29 December 2017, the Hong Kong Government gazetted the Inland Revenue (Amendment) (No.6) Bill 2017, proposing to codify transfer pricing principles into Hong Kong tax legislation.

The amendment bill provides that transactions between two associated persons must be made on an arm's length basis:

- Failure to prove an arm's length transaction will be subject to an adjustment of taxable profits.
- "Associated persons" is widely defined that two persons will be regarded as associated if one person participates in the management, control or capital of the other person (which includes corporation, partnership, incorporated or unincorporated trustee or a body of person).
- "Control" can be determined by reference to beneficial interest, voting rights or powers conferred by constitutional documents, obligation or accustom to act in accordance with one's directions, instructions or wishes.

In addition, a non-Hong Kong resident who is regarded as having a permanent establishment ("PE") in Hong Kong will be deemed as carrying on a trade, profession or business in Hong Kong for Hong Kong profits tax purposes:

- The income of such non-Hong Kong resident that is attributable to the PE will be determined as if the PE is a distinct and separate enterprise.
- A resident coming from territory having double tax arrangement ("DTA") with Hong Kong will make reference to the DTA concerned to determine whether there is a PE. A resident coming from territory not yet having any DTA with Hong Kong will be regarded as having a PE if it has a fixed place of business in Hong Kong. The amendment bill has included examples on fixed place of business (e.g., a place of management, a branch, or an office). Besides, PE may also be constituted by agent's activities.

It is expected that the amendment bill will be finalized and enacted by the end of 2018. The new transfer pricing provisions will have implications for related party transactions between companies owned by clients and trusts.

Specifically, such related party transactions (e.g., loans) will need to be conducted at arm's length.

It is important to note that the transfer pricing provisions apply to both cross-border and domestic related party transactions. Related party transactions above certain thresholds will be subject to mandatory transfer pricing documentation requirements.

Trustee licensing

The new licensing regime for trust and company service providers ("TCSPs") has come into force on 1 March 2018 under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance ("AMLO").

Under the new licensing regime provided by the AMLO, any person who wishes to carry on a trust or company service business in Hong Kong is required to apply for a TCSP licence.

The applicant, including its ultimate owner, director or partner (in the case of partnership) need to satisfy a "fit-and-proper" test before licence will be granted by the Hong Kong Companies Registry ("HKCR").

TCSPs are also required to comply with statutory due diligence and record-keeping requirements under Schedule 2 of AMLO.

As a transitional arrangement, a person will be deemed to have been granted a TCSP licence to carry on a trust or company service business if immediately before 1 March 2018 it was carrying on a trust or company service business in Hong Kong and held a valid business registration certificate for that purpose.

The deemed licensee needs to submit application to the HKCR for the formal TCSP licence on or before 28 June 2018. The deemed licence will end thereafter.

Register of significant controllers

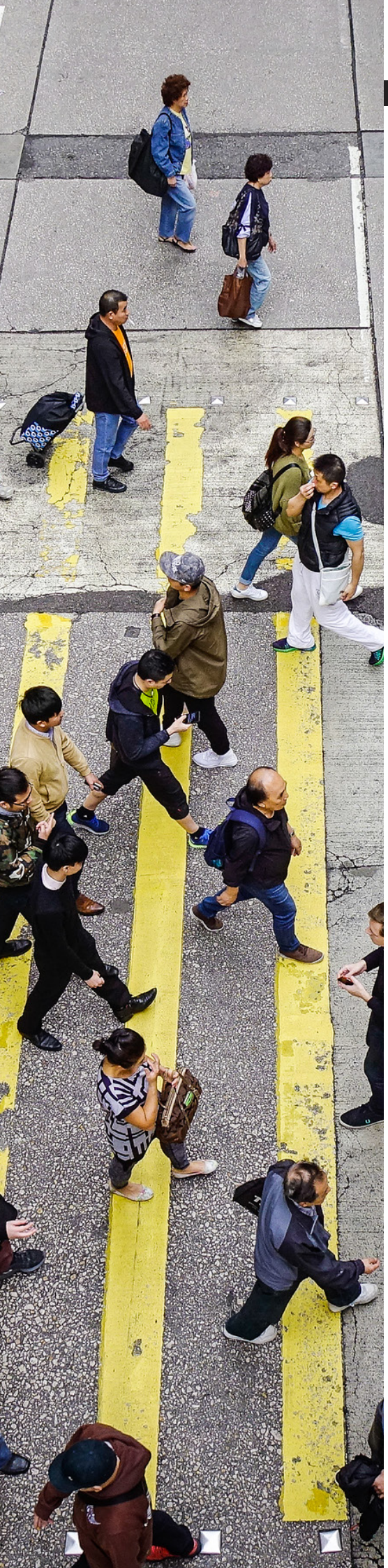
The Companies Ordinance ("CO") has also been amended with the amendments coming into operation on 1 March 2018, introducing new statutory requirements on Hong Kong companies to keep a significant controllers register ("SCR").

For the purposes of the SCR, a person will be regarded as having significant control over a company if he meets one or more of the following conditions:

- directly or indirectly holding more than 25% of the shares;
- directly or indirectly holding more than 25% of the voting rights;
- directly or indirectly holding the right to appoint or remove majority of directors;
- having the right to exercise, or actually exercising significant influence or control; or
- having the right to exercise, or actually exercising, significant influence or control over the activities of a trust or a firm that is not a legal person, but whose trustees or members satisfy any of the first four conditions (in their capacity as such) in relation to the company.

The SCR should contain information on the individuals ("Registrable Person") as well as legal entities ("Registrable Legal Entity") which have significant control over a particular company, including:

- the name of the Registrable Person or Registrable Legal Entity;
- the number of the identity card, or the number and issuing country of any passport, of the Registrable Person;
- the legal form of the Registrable Legal Entity (including the law by which it is governed) and the company registration number or the equivalent in its place of incorporation or formation;
- the correspondence address (excluding post office box number) of the Registrable Person, and the address of the registered or principal office of the Registrable Legal Entity;
- the date when the individual became a Registrable Person, and the date when the legal entity became a Registrable Legal Entity; and



- the nature of the control of the Registrable Person or of the Registrable Legal Entity over the company in accordance with the specified conditions.

Due to widespread concerns for privacy and having regard to the prevailing international practice, access to the SCR will be restricted to competent authorities only, and will not be available for inspection by the general public. All entries in the SCR relating to a significant controller may be destroyed only after 6 years from the date the person ceased to be a significant controller of the company.

Under the CO, not only the company has a duty to identify, obtain and update the information on its significant controllers, any person who has received a notice relating to the SCR issued by a company must also respond and comply with the requirements stated in the notice (i.e., by providing or confirming the requested information) within one month from the date of the notice.

Open-ended fund companies

The Government has proposed to extend the profits tax exemption currently enjoyed by publicly offered open-ended fund companies and certain offshore funds, to onshore privately offered open-ended fund companies ("Private OFC"). The amendment ordinance has been gazetted and the new law will come into operation in year 2018.

In order to enjoy the exemption, a Private OFC must satisfy the following conditions:

- Resident in Hong Kong, with its central management and control located in Hong Kong.
- Not closely held, i.e., not owned by only a few individuals or corporate investors.
- All transactions generating profits must be carried out or arranged by corporations or authorized financial institutions licensed or registered under the Securities and Futures Ordinance.
- Only invest in permissible asset classes, which should largely involve securities and futures contracts, with a 10% de minimus limit for investing in non-permissible asset classes.

The final amendment ordinance further provides that a Private OFC could enjoy profits tax exemption on its investment in private companies ("investee companies") if: (a) the investee companies do not hold, directly or indirectly, more than 10% of their assets in local immovable property; and (b) 50% or more of the investee company's assets should be held for more than three years.

There are specific requirements imposed on the second condition of "not closely held":

- Private OFCs must have at least ten investors, not including the originator or its associates. The minimum number of investors reduces to five where there is a qualified investor. A "qualified investor" means certain specified types of institutional investors, including pension funds, publicly offered funds, governmental entities and organisations established for non-profit making purposes.
- For those Private OFCs with at least one qualified investor, the participation interest of each qualified investor must exceed HKD200 million , whereby each of the other non-qualified investors must have a more than HKD20 million participating interest and such interest must not exceed 50% of the company's issued share capital.
- For those Private OFCs without qualified investor, the participation interest of each investor shall be more than HKD20 million and such interest must not exceed 50% of the company's issued share capital.
- Regardless whether there is a qualified investor, the participating interest of the originator and its associates must not exceed 30% of the company's issued share capital.
- The fund documents must include specific terms stating that interests in Private OFC will not be closely held and the intended categories of investors. But nothing in the fund document should be used to limit the investors to any specific individual or company, or deter any other reasonable investor.

If a Private OFC fails to meet the "not closely held" condition, a safe harbor rule will permit it to apply to the Commissioner of Inland Revenue for tax exemption if:

- its activities and investments are being wound down and it has notified its members of the decision to wind down its activities and investments; or
- there are temporary and out-of-control circumstances.

For the last condition, the fund may apply for exemption if the 10% threshold is exceeded due to circumstances (such as market fluctuations) which significantly reduce the value of the Private OFC's assets and were not reasonably foreseeable.

Private OFCs are potentially useful for managing the assets of multiple families onshore while enjoying a tax exemption in the same way as offshore funds. ■