

## **Suggested Modifications to Conditions for Section S13X Master-SPV Structures**

### **Removing economic commitment requirements for all structural SPVs**

Economic commitment requirements should be lifted for SPVs in the holding structure that is set up purely for structural purposes (i.e. “Structural SPVs”). Structural SPVs should be defined to mean special purpose vehicles that are solely set up to hold the shares of a subsidiary or a portfolio company and does not have any other activities or operations.

To prevent abuse, structural SPVs should not include listed entities and entities with active business operations or trading activities. They should only be holding investments that are within the fund mandate of the main fund vehicle that has been awarded the Section 13X incentive. As long as the main fund and fund manager meet the Section 13X conditions and thresholds, there seems to be no reason to impose additional economic requirements on purely structural SPVs that fall within the above definition.

Hong Kong’s offshore fund regime exempts offshore funds from tax in respect of investments outside of Hong Kong. This includes investment gains made by an SPV from the disposal of an offshore portfolio investment. There is no limit on the number of interposing SPVs, provided all the necessary criteria are met. Amongst other conditions set out in the detailed legislations, an SPV is:

- a) A corporation, partnership, trustee of a trust estate or any other entity;
- b) Wholly or partially owned by a non-resident person (i.e. an offshore fund);
- c) Established solely for the purpose of holding, directly or indirectly, and administering one or more excepted private companies;
- d) Incorporated, registered or appointed in or outside Hong Kong;
- e) Not carry on any trade or activities except for the purpose of holding, directly, or indirectly, and administering one or more excepted private companies.

The above conditions can be similarly applied to define “structural SPVs”.

### **Expanding S13X to cover SPVs that are not 100% owned by the Master Fund**

Currently, the Section 13X exemption only covers SPVs that are wholly owned by the Master Fund. This should be expanded to cover SPVs where the Master Fund holds a majority stake (i.e. more than 50% equity stake).

Referring again to Hong Kong’s offshore funds regime (condition b above), there is no requirement for the SPV to be 100% owned by the fund.

### **Expanding the scheme to cover beyond two tiers of SPVs**

Private funds use SPVs for a number of reasons:

- a) Ring-fence potential liabilities or losses:
  - Any losses suffered by one portfolio company do not affect other portfolio companies or the fund.
  - The fund is isolated from liability for portfolio company losses.
  
- b) Facilitate ease of sale:
  - It is often easier to sell an SPV than a portfolio company due to potential licensing, approval, or tax issues at the portfolio company level.
  
- c) Accessing tax treaties:
  - Funds are usually setup in the Cayman Islands which has no tax treaties. Using SPVs in jurisdictions that have tax treaties, like Singapore and Hong Kong, to hold specific portfolio companies may provide tax benefits.
  
- d) Allow for different economic rights and/or control rights for different participants in an investment:
  - An SPV may be used to give co-investors full economics but little or no voting rights/control.
  - If different co-investors are given different levels of economic or control rights, multiple SPV layers may be required.
  
- e) Satisfy demands of lenders and simplify lending structures:
  - Lenders generally prefer the borrower to be a single purpose entity that is prohibited from conducting any business activity other than holding the portfolio investment.
  - Lenders generally require a pledge of the shares of the borrower. Having the borrower held by another SPV (as opposed to by potentially multiple shareholders) simplifies the documentation and, if necessary, enforcement of that share pledge.