

# The Hong Kong Limited Partnership Fund Ordinance

Xavier Garralda, Associate, Vistra Hong Kong; and Effie Vasilopoulos, Partner, and David Kalani Lee, Counsel, Sidley Austin, highlight the features of Hong Kong's new Limited Partnership Fund Ordinance designed to boost Hong Kong's standing as an asset management and private equity investment centre in Asia.



As of 31 August 2020, the long-awaited Limited Partnership Fund Ordinance (Cap 637) (LPFO) came into effect in Hong Kong, replacing the outdated Limited Partnerships Ordinance (Cap 37) (LPO) that was enacted back in 1912. Under the LPO, onshore funds could be established in the form of a unit trust or an open-ended fund company, which are not the preferred vehicles for most strategy types adopted by private fund managers including private equity, venture capital, real estate, infrastructure, credit and special situations. Private funds that adopt these strategies are typically structured as limited partnerships. For this reason, it had become the norm for Hong Kong-based private fund managers to set up funds in offshore jurisdictions such as the Cayman Islands. However, with the introduction of the new LPFO, a modern and effective legal regime has been introduced that can facilitate the establishment of funds onshore in Hong Kong in the form of limited partnerships. This development is expected to cement the city's position as a leading centre for asset management and private equity investment in Asia.

### Features of the LPFO

Limited partnership funds that are registered under the new regime all share certain characteristics. Firstly, they must have a General Partner (GP) who is ultimately responsible for the management and control of the fund, and who will assume unlimited liability for the debts and obligations of the fund. The GP can be a natural person, private company, limited partnership or a limited partnership fund. The GP can also simultaneously act in the capacity of an investment manager and assume the responsibility for carrying out the day-to-day management of the fund. Otherwise, the GP must appoint a separate person or company to act as the investment manager.

Secondly, the fund must have at least one Limited Partner (LP) at the date of registration. LPs have no day-to-day management rights or control over the assets of the fund, but rather they have the right to participate in the income and profits arising from the fund. As their name suggests, the liability of LPs for the debts and obligations of the fund is limited to the extent of their agreed contributions. However, if an LP engages in an activity that amounts to managing the fund (not being one of the safe harbour activities that are specified in Schedule 2 of the LPFO), both the LP and the GP may be jointly and severally liable for debts and obligations incurred while the LP takes part in such management activities.

Thirdly, every fund must be governed by a written Limited Partnership Agreement (the Agreement) that is mutually agreed upon by the partners. The Agreement may dictate among other things:

- the admission and withdrawal of partners
- the transfer of interests by LPs
- the governance and decision-making procedures of the fund

- the investment scope and strategy of the fund
- the powers, rights and obligations of the partners
- the scope of the GP's fiduciary duties and the remedies for the breach or default thereof
- capital contributions, withdrawals of capital contributions, distribution of proceeds and clawback obligations, and
- the procedure for the voluntary dissolution of the fund (as a convenient alternative to the right of any partner or creditor to petition the Court to dissolve the fund on just and equitable grounds, or to wind up the fund as an unregistered company pursuant to the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32)).

Funds that are established under the LPFO are subject to uniquely advantageous fiscal arrangements. For instance, they may be exempt from profits tax provided they meet the definition of a 'fund' under Section 20AM of the Inland Revenue

### Highlights

- the Limited Partnership Fund Ordinance (LPFO) came into effect on 31 August 2020, replacing the outdated Limited Partnership Ordinance that was enacted in 1912
- prior to the introduction of the LPFO, it was the norm for Hong Kong-based private fund managers to set up funds structured as limited partnerships in offshore jurisdictions such as the Cayman Islands
- the introduction of the LPFO is expected to cement Hong Kong's position as a leading centre for asset management and private equity investment in Asia

Ordinance (Cap 112) and satisfy certain conditions under the Unified Funds Exemption regime. In addition, funds registered under the LPFO have the benefit of not having any capital duty and/or stamp duty imposed on proceeds arising from the distribution of profits, as well as on the contribution, transfer or withdrawal of a partnership interest to and from a fund. On 7 August 2020, the government announced it will implement a 'highly competitive' concessional tax rate with respect to carried interest for private equity funds, which is expected to take effect retroactively from 1 April 2020.

To ensure transparency in the structure of funds, all funds must continuously update the Registrar of Companies (the Registrar) with basic information that will be publicly available for a prescribed fee. Such information includes the name of the fund, its registered office address and principal place of business, its investment scope and the name and contact details of the GP, investment manager and/or authorised representative. However, the register will not contain information as to the identity or background of LPs. This information is instead maintained on a private and confidential basis at the registered Hong Kong office of the fund.

Other features of the LPFO include:

- the requirement to end the name of the fund with 'Limited Partnership Fund', 'LPF' and/or '有限合伙基金'
- the obligation to maintain a registered office in Hong Kong
- the GP's role in ensuring proper custody of the fund's assets (whether through the appointment of a custodian or otherwise)

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- the GP's duty to appoint an independent auditor for the purpose of auditing the financial statements of the fund annually
- the GP's responsibility to appoint either an authorised institution, a licensed corporation, or a legal or accounting professional to conduct required anti-money laundering measures, and
- the need to have a Hong Kong law firm or solicitor submit the application to register the fund to the Registrar.

As of yet, the LPFO does not allow funds registered in offshore jurisdictions such as the Cayman Islands to re-domicile to Hong Kong. However, funds registered under the LPO may migrate to the LPFO upon the satisfaction of certain eligibility requirements. This process will not result in the creation of a new separate legal entity and thus the pre-existing rights and liabilities of the fund will remain unaffected.

The LPFO regime aims to create a new onshore regime for investment funds while avoiding potential disruption to the businesses and structures of investment funds. For example, no new licensing requirements have been imposed for

limited partnership funds, general partners or investment managers under the LPFO regime. These players will continue to be subject to the current licensing regime of the Securities and Futures Commission of Hong Kong. In most cases where the primary discretionary investment management functions are undertaken from Hong Kong, a Type 9 (Asset Management) licence will be required.

#### The response so far

The investment community's impression of the new LPFO has been overwhelmingly positive, with especially strong interest and support from investors and asset managers in the Greater China region. The industry eagerly awaits further guidance in relation to the proposed tax concessions on carried interest income streams which are expected to be backdated to take effect from 1 April 2020.

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