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Practical cross-border insights into private equity law

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1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions?

Hong Kong is one of the largest private equity hubs in Asia, with around 600 private equity firms and over US$170 billion of assets under management. Private equity focuses predominantly on transactions outbound from Hong Kong into businesses in Mainland China, across multiple sectors. Transactions in Hong Kong itself often focus on technology, FinTech, logistics and real estate.

1.2 What are the most significant factors currently encouraging or inhibiting private equity transactions in your jurisdiction?

The overall state of the private equity market has been adversely affected by economic headwinds consequent to strict COVID-19 controls both in Hong Kong and Mainland China, as well as uncertainty in government policy.

Beyond political and economic factors, in Hong Kong, the government has introduced a number of initiatives to strengthen Hong Kong as a base for private equity transactions. These initiatives have included the introduction of a new limited partnership fund regime to enable private equity funds to register (or re-domicile) in Hong Kong and the introduction of tax measures to limit profits tax on the exit of portfolio transactions and on carried interest earned from such transactions.

1.3 Have you observed any long-term effects for private equity in your jurisdiction as a result of the COVID-19 pandemic? If there has been government intervention in the economy, how has that influenced private equity activity?

Travel restrictions and quarantine requirements have posed a major challenge to private equity and, as at the time of writing this article, continue to weigh on activity. The Hong Kong government responded to the pandemic with an economic package that, although not intended to stimulate the economy to the extent seen in some other jurisdictions or provide the liquidity to spur M&A activity, included subsidies to support employment and to guarantee loans.

1.4 Are you seeing any types of investors other than traditional private equity firms executing private equity-style transactions in your jurisdiction? If so, please explain which investors, and briefly identify any significant points of difference between the deal terms offered, or approach taken, by this type of investor and that of traditional private equity firms.

There has been growing participation in private equity transactions by family offices. By way of background, in 2020 there has been an approximate 46% year-on-year increase in the assets under management in Hong Kong's private banking and private wealth management business attributed to family offices and private trust clients. With the recent legislative proposal to provide tax concession for eligible family-owned investment holding vehicles managed by single family offices in Hong Kong, in order to further attract ultra-high-net-worth individuals to set up and operate family offices in Hong Kong, it is expected that family offices may become an emerging investor base for private equity funds alongside traditional institutional investors.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction?

Private equity transactions in Hong Kong typically use an offshore company to hold a Hong Kong company, which, in turn, holds the underlying business in which the investment is being made.

2.2 What are the main drivers for these acquisition structures?

Transactions in shares of Hong Kong companies are subject to stamp duty and the use of an offshore company can enable an exit of an investment without stamp duty.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

Institutional private equity investors may take ordinary shares, preferred shares, convertible notes or a combination of the foregoing. When possible, convertible notes provide the upside of equity as well as some downside protection as a creditor. Preferred shares may provide for redemption rights as well as the right to convert into ordinary shares.

Management may take ordinary shares, typically to align their interests with those of the institutional investors, sometimes as sweet equity and sometimes as part of a rollover. Management may receive additional shares subject to ratchet mechanisms to incentivise performance. Management shares may be voting or, in some cases, non-voting.

Carry is typically addressed at the fund level rather than at the portfolio level.

2.4 If a private equity investor is taking a minority position, are there different structuring considerations?

In a minority position, the private equity investor will wish to put in place a shareholders' agreement. The investor may seek to include in this agreement various rights to ensure the business is governed in a manner satisfactory to the investor. These rights may include the right to board representation and veto rights over certain company activities. The latter may include restrictions on transactions otherwise than on an arm's-length basis and transactions that would incur liabilities beyond a prescribed threshold. Other rights, such as tag-along rights, pre-emptive rights, and rights of first refusal, may be included to protect the investor's ability to exit with other shareholders, to protect the investor from being diluted and to protect the investor from being forced into a relationship with an unknown or unfriendly shareholder.

A controlling shareholder may seek to include in the shareholders' agreement drag-along rights and a right of first offer to ensure that it is able to effect an exit through a sale of the whole business and to protect itself from being forced into a relationship with an unknown or unfriendly shareholder.

2.5 In relation to management equity, what is the typical range of equity allocated to the management, and what are the typical vesting and compulsory acquisition provisions?

Management equity will vary depending on the size and the specific terms of each transaction, as well as on any management shareholding existing at the time of a transaction. It would not be uncommon to see total management equity in the range of 10% to 20% of the ordinary share capital with vesting over a period of three to five years. A private equity investor will typically seek a right to compulsorily acquire management equity from an executive who ceases employment with the business.

2.6 For what reasons is a management equity holder usually treated as a good leaver or a bad leaver in your jurisdiction?

Generally, a management equity holder will be treated as a good leaver if leaving for reasons of death, ill health, or retirement. On the other hand, a management equity holder may be treated as a bad leaver if leaving voluntarily ahead of meeting agreed milestones, if terminated for cause or in any circumstance otherwise than as a good leaver.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

See the response to question 2.4. Generally, governance arrangements are not publicly available as they are set out in the shareholders' agreement and this agreement is a private document that will not need to be filed with any public registry. This is so where the investment is made into a Hong Kong company or in a company incorporated in any of the offshore jurisdictions that are typically chosen.

However, certain governance arrangements may need to be supported by provisions in the articles of association or other constitutional documents of the private equity portfolio company. This is because a shareholders' agreement is a contractual document that binds the shareholders who are parties to it but which may not bind the company. In this case, these provisions may be registered with a public registry and may be available through a public search.

For example, if a private equity investor and a founder agree in the shareholders' agreement that each will have the right to appoint a director to the board, it may be convenient to provide in the articles of association for two classes of ordinary shares, each class having its own right to appoint a director.

3.2 Do private equity investors and/or their director nominees typically enjoy veto rights over major corporate actions (such as acquisitions and disposals, business plans, related party transactions, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

Each transaction will vary as to veto rights. However, private equity investors will generally seek veto rights over changes to the company's share capital structure, acquisitions and disposals of key assets, related party transactions, the incursion of liabilities (or business plans and budgets) above certain pre-agreed thresholds, and other proposed changes that may have a material impact on the company's financial performance.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

Hong Kong company law generally operates on the basis that the management of a company rests with the board of directors, meaning that the shareholders have no right to manage the day-to-day affairs of a company unless specifically authorised to do so by the articles of association. It is unusual to reserve specific management decisions to the shareholders in the articles of association. As a result, veto rights at the shareholder level will normally be limited to matters within the statutory jurisdiction of the shareholders.

Conversely, Hong Kong company law generally reserves to the shareholders certain decisions and the board of directors has no right to make these decisions. As a result, veto rights at the board level will normally be limited to matters that fall within the day-to-day management of the company only and that are outside the range of decisions reserved by company law to the shareholders.

At the same time, Hong Kong company law provides that certain shareholder decisions must be taken either by ordinary resolution (meaning a resolution passed by a simple majority) or by special resolution (meaning a resolution passed by a majority of at least 75% of the shareholders present or voting on a poll) and any agreement purporting to bind the company to a different threshold of approval is unenforceable.

To address these limitations, veto rights are normally set out in a shareholders' agreement. The company is specifically excluded as a party to this agreement and the shareholders are obliged under the agreement to procure a state of affairs to give

effect to the veto rights. As these steps only provide contractual protection and do not stop decisions in breach of contractual veto rights having effect as a matter of company law, careful consideration must be given to whether veto rights will be placed at the shareholder level or the board level and amendments to the articles of association may be adopted.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

Under Hong Kong company law, shareholders generally owe no duties to other shareholders as regards how they vote or otherwise how they exercise rights attached to their shares.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

Under Hong Kong law, shareholders' agreements are generally enforceable provided that they do not purport to bind the company to a position that is inconsistent with statutory company law requirements. This means that whilst private equity investor shareholders are generally free to make personal agreements (*e.g.* in relation to the exercise of their personal voting rights) to bind one another, a shareholders' agreement will be unenforceable to the extent that it, for example, fetters a company's right to undertake an act (*e.g.* to alter its articles or remove a director, provided that the requisite resolutions have been passed) that the company is entitled to undertake pursuant to companies law legislation.

Similarly, Hong Kong law generally recognises choice of law and jurisdiction clauses. Sometimes, in the context of a shareholders' agreement, a party may wish to align the law of the contract with the law of the company to ensure consistency. Investment documentation involving a Mainland Chinese counterparty may reflect enforcement needs, including the possibility of an exclusive Hong Kong jurisdiction clause for a Hong Kong court to render a judgment that can be enforced in Mainland China by treaty, or the use of arbitration for dispute resolution to take advantage of a number of treaties providing for enforcement in Mainland China of interim and final awards in arbitral proceedings seated in Hong Kong.

In principle, non-compete and non-solicit provisions are enforceable in Hong Kong provided that they protect legitimate business interests and the restraint in question is no more than is reasonably necessary to protect those interests. However, as enforcement of such provisions require the exercise by the court (or arbitral tribunal) of discretion as to reasonableness, the parties may prefer to seek protection through clauses restricting the disclosure and use of confidential information.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies?

Directors owe duties under Hong Kong law, including a statutory duty of care to exercise reasonable care, skill and diligence as well as a fiduciary duty to act *bona fide* in the best interest of the company. These duties may limit the ability of nominee directors to act solely in the interest of the shareholders appointing them. A breach of these duties may result in personal liability for a director.

As a general principle, the shareholders may ratify breaches of these duties by a director. A private equity investor cannot vote to ratify a breach by a director connected to it (*e.g.* an employee of the private equity sponsor) but the shareholders' agreement may require another shareholder to vote to ratify a breach consistent with this agreement.

Directors may owe other duties in specific circumstances. For example, if a portfolio company goes public, under Hong Kong law, directors consenting to or authorising the issue of the prospectus may be liable for any untrue statement. It is not possible to ratify a breach of such a duty.

As shareholders, as a matter of company law, private equity investors do not owe duties to the directors whom they nominate. Liability may attach under employment law to private equity investors as employers of employees whom the private equity sponsor may nominate as a director.

Hong Kong company law restricts a company from indemnifying a director for liability of a director to the company for breaches of duties owed by the director to the company. A company may take out directors & officers liability insurance to indemnify a director from expenses in defending proceedings alleging default by a director.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Under Hong Kong company law, a director must declare to the board any direct or indirect material interest the director may have in a proposed arrangement being considered by the board that is significant to the company. The articles of association of companies often provide that a director must refrain from voting in respect of such an arrangement and must not be counted in the quorum of the board meeting to consider that arrangement.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including antitrust, foreign direct investment and other regulatory approval requirements, disclosure obligations and financing issues?

Hong Kong laws do not generally impact transaction timetables but specific circumstances may result in the application of laws that may do so. Most significantly, if a portfolio company is regulated, regulatory approvals may delay the timetable. For example, if the portfolio company is licensed by the Securities and Futures Commission ("**SFC**"), a transaction in which the private equity investor becomes a substantial shareholder cannot complete until the SFC approves the investor and any entities in the holding chain.

There are no anti-competition or anti-monopoly merger controls that apply generally in Hong Kong. Merger controls currently only regulate mergers involving telecommunications carriers.

4.2 Have there been any discernible trends in transaction terms over recent years?

There has been an enhanced emphasis on integrating environmental, social and corporate governance ("**ESG**") factors into investment selection, due diligence and portfolio value creation processes.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

A public-to-private transaction in Hong Kong structured as a share acquisition is subject to the SFC Code on Takeovers and Mergers ("**Takeovers Code**").

As companies listed on the Stock Exchange of Hong Kong ("**SEHK**") are often controlled by a family or a single controlling shareholder, a typical take-private deal may take the form of either (i) a sale and purchase agreement with the controlling shareholder followed by a general offer, or (ii) a voluntary offer with a pre-agreed irrevocable commitment from the controlling shareholder to accept this offer.

In the former, the general offer will be mandatory if the private equity investor acquires 30% or more of the voting rights of the company from the controlling shareholder.

The Takeovers Code requires that all shareholders in a general offer be treated fairly and equally, and hence, as a principle, the private equity investor must offer terms to the non-controlling shareholders at least as good as those offered to the controlling shareholders.

A mandatory general offer cannot be subject to any conditions other than a condition ("**acceptance condition**") that the buyer receive acceptances to the offer to secure more than 50% of the voting rights of the company. However, a voluntary offer may be subject to other conditions.

It should be noted that if a buyer needs to arrange financing for an offer, the financing must in any event be in place before it makes the offer.

5.2 What deal protections are available to private equity investors in your jurisdiction in relation to public acquisitions?

Because most companies listed on the SEHK have a controlling shareholder, it is possible for a private equity investor to negotiate deal protections in arrangements with the controlling shareholder. For example, where a private equity investor acquires the shares of the controlling shareholder and then makes a mandatory general offer, the purchase and sale agreement between the investor and the controlling shareholder may include common deal protections such as representations and warranties and indemnities from the controlling shareholder.

However, the Takeovers Code imposes certain restrictions that may limit the availability of deal protections that otherwise might be available to a private equity buyer in a private acquisition. For example, the Takeovers Code limits the ability of a buyer to enter into special deals with selected shareholders if those arrangements have favourable conditions that are not extended to all shareholders. As a result, private equity investors may require regulatory consent before offering retention incentives to company management who have existing equity stakes in the company.

On the flip side, the Takeovers Code offers certain inherent safeguards for a buyer. Most significantly, in the absence of shareholder approval, the Takeovers Code prohibits a target company from taking any action to frustrate an offer once the offer has been communicated to the board.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

Cash consideration is generally preferred in private equity deals. Post-completion price adjustment mechanisms are commonly seen and adjustments are usually based on net assets, working capital or a combination of both. Locked-box mechanisms are sometimes used to provide greater certainty for private equity sellers in exit deals.

6.2 What is the typical package of warranties / indemnities offered by (i) a private equity seller, and (ii) the management team to a buyer?

Private equity sellers usually give limited representations and warranties (*e.g.* relating only to the seller's title to the shares, and capacity and authority for entering into the sale). Management teams are usually expected to give extensive warranties (*e.g.* relating to audited and management accounts, accuracy of disclosure materials) to a buyer.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

Some pre-completion covenants may require that the seller procure the target portfolio company not to engage in certain conduct that may otherwise diminish the value of the company post-signing. It is also increasingly common to see data privacy and sanctions-related warranties.

Management teams may be subject to non-compete and non-solicit provisions for a certain period post-completion (see question 3.5).

6.4 To what extent is representation & warranty insurance used in your jurisdiction? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such insurance policies, and what is the typical cost of such insurance?

Representations and warranties insurance is gaining popularity in Hong Kong. Policy limits typically range between 10–20% of the deal value. The policy will generally exclude cover for known matters, specific indemnities (*e.g.* indemnity for tax liability, litigation or environmental claims) and forward-looking statements. The premium typically ranges between 2–3% of the policy limit.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

Liability for limited warranties (*e.g.* title) will often be capped at the purchase price. Liability for general warranties will typically be capped at up to 30–50% of the purchase price.

6.6 Do (i) private equity sellers provide security (e.g., escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

Escrow and retention amounts are less commonly used now as more parties are looking to manage risks by representations and warranties insurance.

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain in the absence of compliance by the buyer (e.g., equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

As private equity buyers often use a newly incorporated special purchase vehicle with little financial substance or creditworthiness to act as the buyer entity, to provide comfort to the seller that the buyer entity will be able to meet its obligations to pay the purchase price upon completion, private equity buyers funding the purchase may issue an equity commitment letter in favour of the buyer entity, but would generally resist granting the seller specific third-party rights to enforce such commitment letter. Where part of the purchase will be funded by debt financing to be provided by a third-party lender, debt commitment letters may be issued by the lender in favour of the buyer entity, though these may not be enforceable by the seller.

Sometimes, a seller may require a buyer to provide a guarantee in the seller's favour to guarantee the buyer entity's completion obligations. In circumstances where the buyer entity agrees to pay to the seller a reverse break fee in the event that it fails to complete the purchase due to lack of finance, the private equity buyer may provide a limited guarantee in favour of the seller up to the amount of the reverse break fee.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees are sometimes used (see question 6.7) but are not widely seen in Hong Kong.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

An initial public offering ("**IPO**") remains a popular exit channel for private equity investors. In Hong Kong, there are two options for an IPO; namely a listing on the Main Board ("**Main Board**") of the SEHK or a listing on the Growth Enterprise Market ("**GEM**") Board of the SEHK.

A listing on the Main Board requires (among others) satisfying one of the following tests:

- Profit Test – The listing applicant must have a trading record of not less than three financial years, during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK$35 million and, in respect of the two preceding years, be in aggregate not less than HK$45 million.
- Market Capitalisation/Revenue/Cash Flow Test – The listing applicant must have a market capitalisation of at least HK$2 billion at the time of listing, revenue of at least HK$500 million in the most recent audited financial year, and positive cash flow from operating activities of at least HK$100 million in aggregate for the three preceding financial years.
- Market Capitalisation/Revenue Test – The listing applicant must have a market capitalisation of at least HK$4 billion at the time of listing and revenue of at least HK$500 million in the most recent audited financial year.

A company seeking a listing on GEM must, among others, have a positive cash flow from operating activities of at least HK$30 million in aggregate for the two preceding financial years and a market capitalisation of at least HK$150 million at the time of listing.

Private equity investments made in close proximity in time to a listing on the SEHK may be subject to restrictions on the types of terms available to the private equity investor on the basis that the private equity investor should not receive terms more favourable than the investing public without assumption of real market risk.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

In a Main Board listing, a controlling shareholder (*i.e.* a shareholder controlling the exercise of 30% or more of the voting power at general meetings, or the composition of a majority of the board of directors) of the listed company is not allowed to dispose of its shares for up to six months (*i.e.* first lock-up period) from the listing date. Thereafter, it is not allowed to dispose of its shares for a further six months (*i.e.* second lock-up period) if such disposal would result in it ceasing to be a controlling shareholder.

Similarly, in an exit by a GEM listing, a first lock-up period of 12 months followed by a second lock-up period of 12 months applies.

Private equity sellers who are controlling shareholders would be expected to give undertakings consistent with regulatory requirements. Private equity sellers who are cornerstone investors may be expected to give undertakings not to dispose of their shares for six to 12 months from the listing date, such undertakings to be subject to consent by the underwriters.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Whilst the possibility of exiting by a sale or by an IPO will generally be considered, a decision on exit is usually made before a seller is heavily invested into either option; it has, therefore, historically been less popular in Hong Kong to pursue a dual-track exit process. Recent reversals in the Hong Kong market may affect this dynamic.

7.4 Do private equity sellers seek potential mergers with SPAC entities as an alternative to an IPO exit? What are the potential market and legal challenges when considering a "de-SPAC" transaction?

As the listing regime for special purpose acquisition companies ("**SPACs**") in Hong Kong only came into effect on January 1, 2022 and the first SPAC only listed on the Main Board in March 2022, as at the time of writing, there has not been a de-SPAC

transaction so far. It remains to be seen whether private equity investors may seek potential de-SPAC mergers over an IPO exit.

Based on the current landscape, it is possible to expect more SPAC listings seeking to identify de-SPAC targets with businesses in the Greater China area in the "new economy" sectors such as green energy, advanced technology, healthcare, biotechnology and life sciences, the consumer lifestyle and retail sector, as well as the financial services and technology sector.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high-yield bonds).

Historically, banks have been the most common providers of financing for private equity transactions but more alternative (non-bank) lenders are entering this space. Capital call lines and acquisition financing secured by the shares being acquired continue to dominate but more difficult borrowing conditions have seen an uptick in interest in non-traditional products, which may, for example, call for a broader package of security over a pool of securities of portfolio companies.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

Hong Kong law restricts companies incorporated in Hong Kong from providing financial assistance for the purchase of their own shares. These restrictions may, for example, limit the ability of a purchaser of a target portfolio company from using the assets of that company to secure the debts incurred by the purchaser in financing the purchase. However, particularly in the context of a control transaction, these restrictions may not apply if, for example, among other things, the directors of the target portfolio company confirm that the company is solvent and resolve that the giving of the financial assistance is proper.

8.3 What recent trends have there been in the debt-financing market in your jurisdiction?

Please see our discussion at question 8.1.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

Offshore structures are common for tax purposes but new tax legislation allows for more local Hong Kong structures.

As noted in question 2.2, transactions in shares of Hong Kong companies may be subject to stamp duty. The use of a company incorporated offshore (*i.e.* outside Hong Kong) to hold a portfolio company can bypass stamp duty on a sale of the portfolio company.

Where a person is regarded as carrying on a business in Hong Kong and has profits arising in or derived from Hong Kong from such business, profits of the person may be subject to Hong Kong profits tax.

The place of incorporation of a company neither determines where it carries on a business nor where its profits arise in or are derived from. However, where the management and activities of a company lie offshore outside Hong Kong, the company may be regarded as outside the reach of Hong Kong profits tax. Such a company, if used to hold a portfolio company, may not be subject to profits tax on any gain in the value of its investment in the portfolio company.

Under Hong Kong tax laws, a private equity fund and its holding vehicles may be exempt from Hong Kong profits tax if they meet qualifying conditions. These conditions include a requirement that either (i) the fund sponsor be licensed by the SFC or that transactions for the fund otherwise be arranged by a person licensed by or registered with the SFC, or (ii) the fund have a minimum number of arm's-length investors who have given capital commitments to a minimum level. Other conditions relate to holding periods or control over a portfolio company.

9.2 What are the key tax-efficient arrangements that are typically considered by management teams in private equity acquisitions (such as growth shares, incentive shares, deferred / vesting arrangements)?

Hong Kong tax laws offer limited room for tax sheltering or deferral for share-based awards. Benefits associated with share-based awards arising from an individual's office or employment will be included in his or her assessable income for the purpose of assessing Hong Kong salaries tax. The individual will be assessed on the gains realised under a share award when the shares vest or, in the case of a share option scheme, when the option is exercised.

9.3 What are the key tax considerations for management teams that are selling and/or rolling over part of their investment into a new acquisition structure?

The sale of management team shares to the buyer or the transfer of such shares into a new holding vehicle for the business may trigger stamp duty and, potentially, profits tax.

However, it is possible that any profit arising from such sale or transfer may be exempt from profits tax on the basis that it is a capital gain or on the basis that management is not carrying on a business, profession or trade in such shares.

Stamp duty applies if the shares are shares of a Hong Kong company. However, it may be possible to minimise stamp duty if the Hong Kong company issues new shares to the acquisition vehicle on a thin capital basis.

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

Over the past few years, the Hong Kong government has introduced a number of tax initiatives to strengthen Hong Kong as a private equity hub.

One initiative is the introduction of a new exemption, known as the unified funds exemption, which exempts qualifying profits earned by a private equity fund or its holding vehicles from Hong Kong profits tax arising from portfolio transactions.

A second initiative offers a tax concession for private equity fund managers carrying on their business from Hong Kong. Under this concession, such managers pay a 0% rate of profits tax on eligible carried interest.

A third initiative proposes to offer a profits tax exemption on profits earned by single family offices on qualifying private equity transactions if such offices carry on their business in Hong Kong.

10 Legal and Regulatory Matters

10.1 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

These developments have been discussed in our responses to questions 1.2, 7.4 and 9.4.

10.2 Are private equity investors or particular transactions subject to enhanced regulatory scrutiny in your jurisdiction (e.g., on national security grounds)?

There are generally no restrictions on foreign ownership of Hong Kong companies, although some restrictions may apply in certain industries (*e.g.* television and sound broadcasting).

More commonly, in FinTech or financial services-focused private equity transactions where a target portfolio company is (or has direct or indirect interest in) a business regulated by the SFC or the Insurance Authority, completion of the deal may be subject to obtaining substantial shareholder approval under the Securities and Futures Ordinance (see question 4.1), or change of control or other regulatory requirements under the Insurance Ordinance.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g., typical timeframes, materiality, scope, etc.)?

The timeframe and scope of legal due diligence as well as what is regarded as material will depend on the nature of the target portfolio company, the size of the investment and the extent to which representations and warranties may be given by the management team.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g., diligence, contractual protection, etc.)?

A common challenge in this area is differing anti-bribery and corruption ("**ABC**") rules and regulations that may apply to a target portfolio company and the private equity investors respectively. In addition to the use of ABC warranties, common approaches to managing bribery and corruption risks include building into the due diligence process analyses on the nature of the target business, the strength of its ABC policies, and how the company obtains and retains businesses and interacts with external parties.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

Under Hong Kong company law, the principle of separate legal personality applies. As a result, shareholders are generally not liable for the liabilities of a company.

However, where shareholders assume management responsibilities, they may be liable in the same way as directors. Equally, in cases of fraud, a court may lift the corporate veil.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

Though the media has focused on the political situation in Hong Kong, the factors giving rise to Hong Kong's role as a major private equity hub remain intact. These factors include the legal system, the depth of professional talent and the ease of conducting business. COVID-19 restrictions rather than the political environment are key drivers affecting overall deal activity as of the time of writing.

Timothy Loh founded the firm and has led it as a Managing Partner since 2004. He is recognised by independent editorial publications, including *Chambers and Partners*, *The Legal 500 Asia Pacific*, *Who's Who Legal* and *Asialaw Leading Lawyers*, as a leading lawyer, including in financial markets regulation, investment funds, hedge funds, private equity, corporate law and M&A. Timothy has particular expertise advising private equity sponsors throughout a fund's life cycle and in M&A involving financial institutions, including the purchase and sale of SFC licensed corporations and IA regulated insurance companies.

Timothy specialises in wide-ranging white collar matters, and has particular expertise in defending regulatory investigations and enforcement actions, including SFC disciplinary actions and proceedings before the MMT, CFI, CA and CFA. He has represented clients in various seminal cases defining the ambit of the law governing financial markets in Hong Kong. Timothy is qualified in Hong Kong, England & Wales and British Columbia.

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Mary has represented clients in commercial and contractual disputes, including M&A-related disputes, as well as in asset recovery and regulatory enforcement action. Her experience spans both litigation before Hong Kong courts as well as arbitral proceedings before the HKIAC. She has advised clients in regulatory investigations and proceedings, including those brought by the SFC. Mary is qualified to practise in Hong Kong.

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The firm's Private Equity and M&A practice has been recognised as a market-leading practice and its clients, ranging from start-ups to bulge bracket private equity firms, value the depth of its understanding and knowledge of the financial markets and its ability to provide creative and commercial solutions for complex and high-value transactions.

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