Link to Article on website

A Snapshot of Hong Kong's Proposed Tax Concession Regime for Family Offices

The Financial Service and Treasury Bureau (FSTB) announced in a Policy Statement on 24 March several measures with a view to creating a conducive and competitive environment for the businesses of global family offices and asset owners to thrive in Hong Kong.

GET IN TOUCH

Find out more about Withersworldwide

BACKGROUND

These measures include a dedicated regime which aims to provide a tax concession for single 'family offices' operating in Hong Kong. It should be clarified that the tax concession regime proposed under the *Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022* (the '**Bill**')[1] has not yet come into effect. The Bill is still under review by the Legislative Council of Hong Kong and this article refers to the provisions of the Bill as gazetted.

Though Hong Kong adopts a mainly territorial basis of taxation, and entities which hold investments are generally only subject to Profits Tax[2] if they '*carry on trade or business in Hong Kong'* and derive *'Hong Kong sourced'* profits which are *'trading'* (as opposed to capital) in nature the application of these common law principles is fact specific and not clear cut.

In addition, with the recent changes[3] to tax '*specified foreign sourced income*'[4] in Hong Kong, entities carrying on a trade or business in Hong Kong may face a further risk of Profits Tax if they *receive such foreign sourced income in Hong Kong*[5], subject to certain conditions and exceptions[6].

Currently, Profits Tax is charged at 16.5% for corporations (with the first HK$2 million of assessable profits being taxed at 8.25%, subject to certain conditions being met).

The Bill aims to offer certainty such that income derived by a Family Investment Holding Vehicle (**FIHV**) shall be charged at a concessionary tax rate (which will be 0% for the tax year 2022-23) provided that certain conditions are met. The regime aims to benefit families with FIHVs and family offices already operating in Hong Kong, as well as families located overseas who intend to establish their investment teams in Hong Kong.

It is anticipated the Bill will be refined and enacted by the end of April or early May 2023 with the tax concession applying retrospectively from 1 April 2022.

THE CONDITIONS

Relationship between the FIHV and the family office

The Bill seeks to provide a tax concession for an eligible FIHV which holds the investments and which is managed by an eligible single-family office (the '**ESF Office**').

Main requirements for the FIHV and the ESF Office

The FIHV can be any entity, including any legal arrangement; corporation; partnership; or trust, established in or outside Hong Kong. On the other hand, the ESF Office must be a private company.

Both the FIHV and the ESF Office must have their 'central management and control' exercised in Hong Kong. Additionally, one or more members of the 'family' must cumulatively hold at least 95% of the beneficial interest in the FIHV and the ESF Office. Any interest held by parents, spouse, descendants, siblings, niece, nephews, cousins, and their in-laws can be included in calculating beneficial interest[7].

There are also elaborate provisions in the Bill recognizing beneficial ownership of a natural person in an entity by having voting control, or via a trust structure. This means that if the FIHV (or ESF Office) is an underlying company held by a discretionary trust where one or more members of the family are named as a beneficiary (or a class of beneficiaries), the ownership requirement would be met.

Key financial parameters

The key financial parameter is that the total net asset value (NAV) of the Schedule 16C assets (see below) of the FIHVs (and their underlying entities) managed by the ESF Office at the end of each tax year shall not be less than HK$240 million. It is anticipated a Department Interpretation and Practice Note (DIPN) will be published to clarify how the NAV will be calculated and investments valued.

---

[1] Gazetted on 9 December 2022

[2] Under Section 14 of the Inland Revenue Ordinance (the IRO) Cap 112 of the laws of Hong Kong.

[3] The Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Ordinance 2022 enacted on 22 December 2022 introduced a limitation to the Foreign-sourced Income Exemption (**FSIE**) regime in Hong Kong

[4] As defined under new Section 15 H (1) of the IRO, which includes non-Hong Kong sourced dividends, interest and disposal gains from equity interest

[5] Section 15 H (5) of the IRO

[6] The conditions include if the entities are considered 'MNE entities' as defined under Section 15 H of the IRO; and the exceptions include the 'substance' and 'participation' exception as set out in the FSIE regime

[7] Section 4 of the proposed new Schedule 16 E (the "**Schedule**") to the IRO. The definition of 'children' is extensive including adopted / stepchildren/ illegitimate children of either the person or his spouse

In addition, the minimum average number of qualified employees[8] of the FIHV must be adequate in the opinion of the Commissioner for Inland Revenue (**CIR**) and in any event not less than two. The total amount of operating expenditure incurred by the FIHV in Hong Kong from carrying out investment activities each tax year should also be adequate and in any event not less than HK$2 million[9]. It is also expected that there will be further guidance on the substance requirement in a DIPN.

The profits received by the ESF Office (as opposed to by the FIHV) from providing family office management service should be at least 75% of the total profits of the ESF Office each year, where such profits should be subject to Profits Tax. The 75% safe harbour rule allows the ESF Office to derive income from third parties, though it is not the intention of this tax concession to benefit multi-family offices.

Qualifying Transactions

Profits of an FIHV arising from Qualifying Transactions, meaning the profits arising from the disposal of assets listed under Schedule 16C[10], which consist of mainly traditional financial assets, will be taxed at the concessionary rate as long as such transactions are carried out in Hong Kong by the ESF Office.

At first glance it seems that the FIHV may only hold the Schedule 16C assets to qualify for the concession. However, the Bill actually further envisages that the FIHV may hold "specified securities"[11] in "**relevant**" or "**investee companies**" and these companies may themselves hold other assets, such as artwork, cryptocurrencies, non-fungible tokens, immovables located outside of Hong Kong. The profits from the disposal of such specified securities by the FIHV (but not the profits from the disposal of assets by the relevant or investee companies themselves)[12] will still qualify for the concessionary tax treatment, as long as certain tests[13] are met.

In addition, any trading receipts from Incidental Transactions such as interest income arising from the holding of the Schedule 16C assets by the FIHV will also benefit from the concession, provided that they amount to not more than 5% of the trading receipts of the FIHV from both Qualifying Transactions and Incidental Transactions.

Opt in

The FIHV can make an irrevocable election in writing to take advantage of the regime. There is no preliminary approval by the CIR required, but records of ownership and compliance should be kept by the FIHV and ESF Office which may be audited in the future. Families may apply for an advance ruling from the CIR if they wish to ensure their structures are eligible for the tax concession.

THE FUTURE

With the regime, FIHVs managed by a team of asset managers sitting in Hong Kong who are effecting trades and investments for the FIHV should be able to take advantage of the concession as long as the conditions are met. Family asset holding structures, in particular those held by trusts, looking to take advantage of the concession should seek advice as soon as possible. ■

---

[8] i.e. someone who is a full-time employee in Hong Kong who carries out investment activities in Hong Kong and has the necessary qualifications

[9] Although the Bill refers to these requirements as applicable to the FIHV, the Legislative Council brief published on 7 Dec 2022 (the "**Brief**") sets out that the FIHV may still fulfil the requirements by outsourcing its core income generating activities to the ESF Office. The CIR will consider the totality of facts including the investment strategy of the FIHV, types of assets held by the FIHV etc. to determine if there is adequate substance

[10] Schedule 16 C of the IRO, which also applies to the "unified funds regime" under Section 20 AM of the IRO

[11] Meaning the shares, stocks, debenture, loan stock, funds, bonds or notes issued by the private company

[12] Such profits may still be subject to the Profits Tax under the general principles under section 14 of the IRO

[13] These include the 'immovable properties test'; the holding period test; the control test and the short-term assets test. (cf Sections 12 and 13 of the Schedule) and Annex C of the Brief

If you have any queries, please feel free to reach out to us and we will be happy to assist and advise.

Katie Graves
Partner
+852 3711 1636
katie.graves@withersworldwide.com

Tim George
Partner
+852 3711 1722
tim.george@withersworldwide.com

Wei Zhang
Partner
+852 3711 1644
wei.zhang@withersworldwide.com

Deirdre Fu
Special Counsel
+852 3711 1620
deirdre.fu@withersworldwide.com