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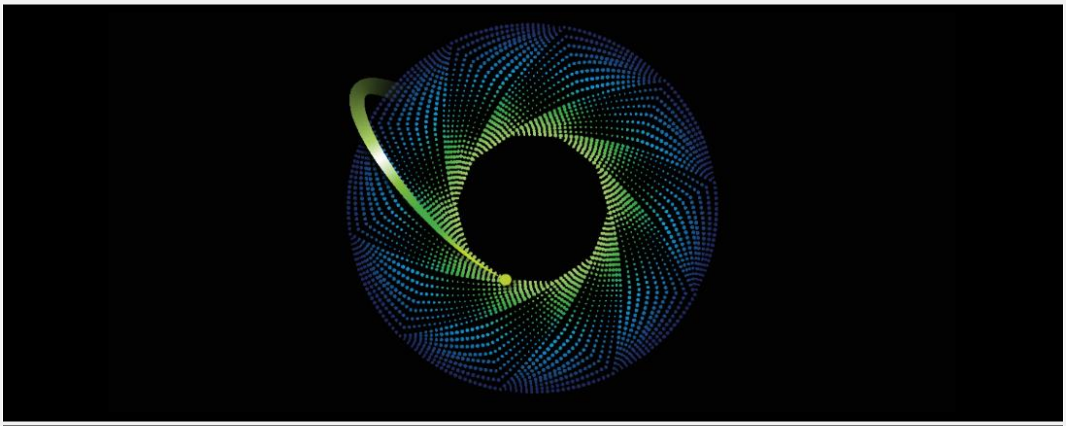

Hong Kong Tax Newsflash
Draft legislation on tax concession for family office gazetted

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The tax concession for family office was announced by the Financial Secretary in February. After industry consultation, the Hong Kong SAR government publishes the relevant draft legislation[1] (the Bill) in the gazette today.

A typical single family office structure contains investment holding vehicles to hold assets for the family and a separate entity as the family office to manage the assets held by the investment holding vehicles. Investment gains usually arise at the investment holding vehicles.

The Bill proposes tax exemption for eligible family-owned investment holding vehicles (FIHVs) that are managed by single family offices (SFOs) in Hong Kong. Special purpose entities established by the eligible FIHVs (FSPE) would also be eligible for the tax concession.

Key features of the tax concession for FIHVs

Eligible FIHV

- A body of persons or a legal arrangement, including a corporation, partnership and trust (including a discretionary trust), established or created in or outside Hong Kong

- Only serve as an investment vehicle for holding and administering the assets, not a business undertaking for general commercial or industrial purposes
- Central management and control in Hong Kong
- At least 95% of its beneficial interest being held (directly or indirectly) by one or more than one member of a single family [see below]
- Managed[2] in Hong Kong by an eligible SFO [see below]

Note*: Not more than 50 FIHVs managed by the same eligible SFO may elect for the tax concession. Once the election is made, it is irrevocable.*

Members of a single family

- Include spouse[3] (including deceased spouse), parent, grandparent, child (including adopted and step child), grandchild, sibling (including spouse's sibling) and their spouse, child etc.

Eligible SFO

- A private company incorporated in or outside Hong Kong
- Central management and control in Hong Kong
- At least 95% of its beneficial interest being held (directly or indirectly) by one or more than one member of a single family
- At least 75% of the assessable profits is arising from the provision of services to an FIHV, FSPE, interposed FSPE and a member of the family (collectively referred to as "specified persons")
- The service fee income derived for the provision of services to specified persons are chargeable to tax in Hong Kong.

Minimum asset threshold

- Aggregate value of specified assets managed by the eligible SFO for the FIHV or multiple FIHVs (including the FSPEs) of the relevant family for a year of assessment[4] must be at least HKD240 million.

Substantial activities requirement

- FIHVs are required to carry out their core income generating activities in Hong Kong.
- The proposed minimum requirements of employee and operating expenditure are as follows:

Number of qualified full-time employees in Hong Kong	Annual operating expenditure in Hong Kong
Not less than 2	Not less than HKD2 million

- Outsourcing of the core income generating activities to the SFO is permitted, according to the Legislative Council Brief.

Qualifying transactions

Assessable profits of FIHV and FSPE from the following qualifying transactions are eligible for the concessionary tax rate of 0% (i.e. tax exempt):

- Transactions in specified assets
  e.g. shares, stocks, debentures, future contracts, foreign exchange contracts and over-the-counter derivative products etc.
- Incidental transactions subject to 5% threshold[5].

For investment in private companies, the immovable property test, holding period test, control and short-term asset test currently applicable to funds under the unified fund exemption regime would also apply to an FIHV and FSPE.

The qualifying transactions must be carried out or arranged in Hong Kong by the eligible SFO.

Anti-avoidance and anti-round tripping provisions

If the main purpose, or one of the main purposes, of the FIHV or FSPE in entering into an arrangement or of a person transferring an asset or business to the FIHV or FSPE is to obtain a tax benefit, the tax concession would not apply. Meanwhile, the tax concession would still apply if the transfer is carried out on an arm's length basis and the transferor is chargeable to tax in respect of the profits arising from the transfer.

The anti-round tripping provisions would be modelled on the existing provisions applicable for funds under the unified fund exemption regime, i.e. if a resident person who has a beneficial interest of 30% or more in a tax-exempt fund or is an associate of a tax-exempt fund, the assessable profits of the fund would be deemed to be the assessable profits of the resident person based on such resident person's ownership percentage. To address the special features of family office arrangement, the anti-round tripping provisions for the family office regime would be modified with two carve-outs: (i) resident individuals; (ii) resident non-individual entities subject to certain anti-abuse measures[6].

Effective date

The tax concession will apply from the year of assessment 2022/23 and onwards if the legislation is enacted.

Our observations

We welcome the introduction of the Bill as it would encourage more family offices to establish a presence and manage their investments in Hong Kong.

We are pleased that the government has taken into account our firm's comments provided during the consultation stage to refine the tax concession regime. For example:

- An eligible FIHV could be a body of persons or a legal arrangement but not limited to a corporation, partnership, or trust. This would allow more FIHVs in different legal form to apply for the tax concession.
- The beneficial interest of the FIHV and SFO that are required to be held by the family members are reduced to at least 95% so that family office structures with charity components would not be excluded from the tax concession.

- Eligible SFOs are allowed to provide services to persons other than the specified persons provided that at least 75% of the assessable profits is derived from the specified persons. FIHVs managed by such SFOs would not be precluded from the tax concession.
- Outsourcing of the FIHV's core income generating activities to the SFO is permitted. This would help the FIHVs maintain the requisite substantial activities requirements.

With the above said, we observe a few unresolved areas of the Bill:

- The Bill only allows tax exemption with respect to qualifying transactions in specified assets. The government should consider broadening the scope to include assets such as digital assets, antiques, art pieces, wine, etc.
- Incidental transactions, including receipt of interest income on securities acquired through "qualifying transactions" are subject to 5% threshold. This would restrict SFOs that hold significant debt securities portfolio from enjoying the tax exemption.

We hope the government could address the above concerns and the Inland Revenue Department could provide more guidance.

Interested parties may contact our professionals to explore the opportunity of enjoying the new tax concession for family office.

[1] The Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022

[2] An FIHV is managed by an eligible SFO if the eligible SFO carries out the investment activities in relation to the FIHV, including conducting research and advising on any potential investments; acquiring, holding and managing or disposing of property; and establishing or administering a FSPE.

[3] If a spouse ceases to be a spouse on or after 1 April 2022, the spouse would still be regarded as members of the relevant family for the subject year of assessment and the following year of assessment.

[4] Consider the aggregate net asset value of the specified assets (Aggregate NAV) at the end of the basis period of the FIHV. In case the Aggregate NAV for a year falls below HKD240 million, the Aggregate NAV for the preceding 2 years would be considered.

[5] The FIHV's trading receipts from incidental transactions must not exceed 5% of the total trading receipts from qualifying and incidental transactions for a year of assessment.

[6] The anti-abuse measures are as follows:

- At least one member of the family has a direct or indirect beneficial interest in the entity;
- The entity is interposed between the family members and the FIHV;
- At least 95% of the beneficial interest in the FIHV must be held by family members; and
- The entity is a passive investment holding vehicle which does not carry on any trade or business.

If you have any questions, please contact our professionals:

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