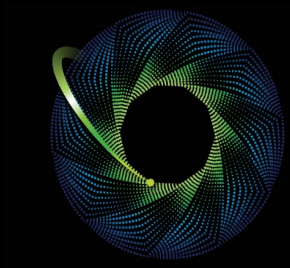
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Hong Kong Tax Newsflash

Refinements to the Bill on enhancement of preferential tax regimes for asset and wealth management industry

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In response to the comments and suggestions received from stakeholders on the draft legislation[1], the government recently published the proposed Committee Stage Amendments (CSA) to amend the Bill and released its responses and clarifications to the stakeholders' submissions, further enhancing the preferential tax regimes for funds, family-owned investment holding vehicles (FIHVs) managed by a single family office (SFO), and carried interest.

In this article, we highlight the key proposed CSAs and the government's clarifications. For details of the draft legislation, please refer to our previous Hong Kong Tax Newsflash Issue 271.

Unified fund exemption (UFE)

- **Asset value threshold[2]**

  Bill amendment:

  - Removing the HKD 240 million threshold for qualifying assets from the definition of "fund-of-one arrangements[3]" and segregating the HKD 240 million threshold as a requirement for application of the exemption.
  - Specifying details for determining the HKD 240 million threshold for fund-of-one arrangements by reference to the SFO regime[4], including:
    - Point in time for valuation – based on the value as at the end of the basis period. A look-back period approach would be adopted (i.e. the value for the preceding two years would be considered if it falls below HKD 240 million in the subject year).
    - Special purpose entities (SPEs) – qualifying assets held by a fund's SPEs may be included, and the basis for determining the extent of the fund's beneficial interest in an SPE is provided.

  Clarification: The value of qualifying assets should be determined in accordance with applicable accounting standards and reported in the financial statements (audited where required). Loans from participating persons need not be deducted when calculating the threshold. However, loans from parties other than participating persons (e.g., bank loans) will be deducted.

[1] Inland Revenue (Amendment) (Preferential Tax Regimes for Funds, Family-Owned Investment Holding Vehicles and Carried Interest) Bill 2026

[2] Applicable to fund-of-one arrangements and the eligibility of the SFO regime.

[3] Newly added under the definition of "fund" in the draft legislation, being an arrangement with only one investor with qualifying investments under management of at least HKD 240 million.

[4] An eligible SFO is also required to manage an aggregate value of qualifying assets of at least HKD240 million for the FIHV(s).

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- **Perpetual funds**

  Bill amendment: Covering perpetual funds which do not have a final closing of sale of interests in the definition of "qualified investment fund"[5], so that they may qualify for the UFE. This is reflected in the reference time point of "24 months after the date on which the originator first accepts subscriptions from investors for making capital commitments".

- **Substantial activities requirement**

  Bill amendment: Deferring the application of the substantial activities requirement to the year of assessment 2027/28 onwards.

  Clarification: The IRD would neither apply a mechanical multiplication or division exercise in determining whether the substantial activities requirement is met, nor introduce a pro-rata mechanism for the minimum operating expenditure threshold of HKD 2 million in cases of partial-year operations. Instead, it would consider the totality of facts and circumstances of each case.

- **New tax reporting mechanism**

  Bill amendment: Extending the election[6] for the new tax reporting mechanism (rather than complying with the existing profits tax return filing requirement) to any funds that are required to furnish tax returns, provided all other conditions are satisfied.

UFE and SFO regimes

- **"Primarily managed" requirement[7]**

  Bill amendment: Clarifying that a fund/FIHV should be able to enjoy tax exemption in respect of profits derived from qualifying assets that are primarily managed in Hong Kong, regardless of the proportion of the fund's investment portfolio managed outside Hong Kong.

- **Precious metals[8]:**

  Bill amendment: Removing the 20% cap, as well as introducing specific anti-round tripping provisions similar to those applicable to loans, i.e. if a person who carries on a business of acquisition and sale of any precious metals in Hong Kong:

  (a) has 20% or more beneficial interest in a fund/FIHV (or any percentage if the fund/FIHV is an associate of the aforesaid person); or

  (b) has control or significant influence over a fund/FIHV,

  the aforesaid person will be deemed to have derived assessable profits in respect of profits derived by the fund/FIHV from "precious metals".

  Clarification: There is no restriction on the trading venue of precious metals. In other words, precious metals traded in Hong Kong or outside Hong Kong would qualify for the exemptions.

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[5] It imposes certain requirements on the number of investors and capital commitments at all times after the final closing of the sale of interest.

[6] Under the draft legislation, the election is limited to limited partnership funds and open-ended fund companies established or registered in Hong Kong.

[7] Under the draft legislation, to qualify for the exemption under the UFE/SFO regime, the qualifying assets of the fund/FIHV must be primarily managed in Hong Kong.

[8] Newly added as a qualifying investment under the draft legislation and proposed to be subject to the condition that the investments in such assets do not exceed 20% of the total investment portfolio.

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- **Property-related ineligible income**

  Bill amendment:

  - Confining ineligible income under Schedule 16L of the Inland Revenue Ordinance to that arising from a business of property trading and property development in respect of immovable property in Hong Kong, so that a one-off property transaction that does not amount to a business will remain exempt under the UFE/SFO regime.
  - Adding definitions relevant to Schedule 16L. Specifically, a business of property trading refers to a business of acquisition and sale of immovable properties (excluding infrastructure) situated in Hong Kong.

- **Anti-round tripping provisions**

  Bill amendment:

  - Adding SPEs held by tax-exempt funds/FIHVs and eligible for tax exemption under the UFE/SFO regime to the list of persons excluded from the application of the anti-round tripping provisions[9].
  - Specifying that where an insurance company carries on both life insurance business and any other business, and the assessable profits from the life insurance business are deemed to be 5% of the premiums, the deemed profits arising from the general and specific anti-round tripping provisions should be attributable to that other business.

  Clarification: The definition of "significant influence[10]" would reference the definition in Hong Kong Accounting Standard 28, i.e. the power to participate in an investee's financial and operating policy decisions of the investee but is not control or joint control of those policies. Indicators of significant influence include board representation, participation in policy-making, material transactions between the investor and the investee, management personnel interchanges, or provision of essential technical information.

- **Additional tests on transactions in a private company[11]**

  Clarification: Whether the additional tests apply depends on the time at which the shares are disposed of. If the shares are disposed of after listing, the additional tests will not apply. If the shares are disposed of while the company remains private, the additional tests will apply.

- **Investment activities**[12] *(for SFO regime only)*

  Bill amendment: The definition of "investment activities" under the SFO regime is non-exhaustive, and whether an activity constitutes an investment activity will be determined on a case-by-case basis.

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[9] Under the current UFE/SFO regime, a resident person who, either alone or jointly with his associates, has a beneficial interest of 30% or more in a tax-exempt fund/FIHV (or any percentage if the fund/FIHV is the resident person's associate) will be deemed to have derived assessable profits in respect of the profits earned by the fund/FIHV from the qualifying transactions and incidental transactions that are exempted from tax under the UFE/SFO regime. The draft legislation excluded certain persons from the application the anti-round tripping provisions.

[10] Under the draft legislation, financial institutions, insurance companies, and persons carrying on a money lending business or an intragroup financing business will be deemed to have derived assessable profits in respect of profits derived by the fund/FIHV from loans if the relevant person has significant influence over a fund/FIHV.

[11] Additional tests apply to transactions in equity investments/interests in private companies and non-corporate private entities for determining whether they may be exempt.

[12] The definition of "investment activity" may affect whether an entity qualifies as an FIHV, given that an FIHV must be managed by an eligible SFO. In turn, whether an FIHV is considered managed by an eligible SFO depends on whether that SFO carries out investment activities in relation to the FIHV.

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Carried interest

Bill amendments

- **Salaries tax concession**[13]**:** Delinking the salaries tax concession from the qualifying person's profits tax concession position, so that the salaries tax concession would apply regardless of whether the qualifying person claims the profits tax concession[14].

- **Multi-manager/multi-strategy funds:** Clarifying that the carried interest tax concession can apply to performance-linked remuneration of a portfolio manager, determined by reference to the profits of the investment portfolio managed by the portfolio manager (rather than the overall profits of the fund), provided the relevant conditions are satisfied.

- **Routing arrangement**[15]**:** Expressly indicating that eligible carried interest may be received or accrued, directly or indirectly, from a qualifying payer for both profits tax and salaries tax purposes.

- **Effective date:** Clarifying that the proposed enhancements do NOT apply to the following eligible carried interest:
  - Salaries Tax – Amounts accrued to a qualifying employee before 1 April 2025, even though the interest is received by the employee on or after 1 April 2025.
  - Profits Tax – Amounts received by, or accrued to, a qualifying person before 1 April 2025, even though the date of accrual falls within the basis period for a year of assessment commencing on or after 1 April 2025 (i.e. year of assessment 2025/26).

Clarifications

- **Eligible carried interest vs. non-qualifying remunerations:** Qualifying persons are permitted to decide when, how, and in what amounts eligible carried interest is paid to each qualifying employee. However, if the sum is fixed in amount or guaranteed irrespective of the performance of a fund (e.g. salaries or guaranteed bonus) or payable at the discretion of the fund management company (e.g. a discretionary bonus which may or may not be paid to an employee), it will not be regarded as eligible carried interest.

- **Qualifying persons and qualifying employees:** The carried interest tax concession can apply to the following persons:
  - Local third-party co-fund managers receiving eligible carried interests distributed by overseas lead fund manager
  - Employees seconded from an overseas related company of a qualifying person
  - Employees directly engaged in the provision of investment management services to a fund in Hong Kong.

  Employees providing supporting services (e.g. office administration, information technology services, etc) will not be covered. Whether an employee is directly engaged in the provision of management services will be determined based on the circumstances of each case. The employee's title or position is not conclusive.

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[13] The draft legislation included a formula for calculating the assessable income of a qualifying employee. Under the formula, income from employment paid out of the eligible carried interest received by, or accrued to, a qualifying person (generally the investment manager / advisor) and exempted from profits tax is deductible.

[14] Certain qualifying persons may choose not to claim the profits tax concession for various reasons (e.g. being subject to global minimum tax).

[15] Under the current regime, eligible carried interest must be paid through the qualifying person to qualifying employees. The draft legislation proposed to remove such requirement.

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- **Location of investment management services:** As long as the employee provides investment management services primarily in Hong Kong (e.g. based on the number of days spent in Hong Kong), he/she will qualify as a qualifying employee even if he/she renders investment management services outside Hong Kong occasionally.

- **Transfer pricing:** Transfer pricing arrangements will not affect the eligibility of the carried interest tax concession. However, the investment manager or advisor in Hong Kong should be remunerated on an arm's length basis.

- **Documentation and supporting evidence:** The government sets out the documentary evidence required, including investment management agreements, employment contracts, side letters and other relevant documents, as well as the employee's job duties and proof of investment management services performed in Hong Kong (e.g. internal communication or correspondence of the fund management company).

- **Timing of assessment:** Where eligible carried interest has accrued to but not been received by a qualifying employee until a subsequent year of assessment, an additional assessment will be raised for the year of accrual when the income is subsequently received.

Transitional administrative measure

- If the 2025/26 tax return has been filed but a tax assessment has not been issued, the tax return can be amended to claim the concession.
- If the 2025/26 tax return has been filed and a tax assessment has been issued, an objection may be lodged against the assessment within the statutory time limit to claim the concession. A late objection may be accepted where taxpayers are prevented from lodging objection within the statutory time limit by reason of absence from Hong Kong, sickness or other reasonable excuse.

Our observation

We are pleased to see that the government has adopted stakeholders' (including our firm's) suggestions collected in the consultation and proposed CSAs and provided clarification on certain issues of stakeholders' concerns. In particular, the deferral of the substantial activities requirement for the UFE regime and the delinking of the salaries tax concession on carried interest from the qualifying person's profits tax concession are both welcome developments. We also welcome the confirmation that the enhanced carried interest concession can apply to multi-manager and multi-strategy funds. As these fund structures represent a significant segment of the global asset management industry, this clarification should further enhance the attractiveness and competitiveness of the regime.

The forthcoming administrative guidance will be important in addressing practical implementation issues, including the transitional treatment of 2025/26 tax returns, the determination of the HKD 240 million threshold for funds-of-one arrangements and the eligibility to the SFO regime, and the detailed guidance for the carried interest concession. Timely and practical guidance will help enhance certainty and promote the consistent application of the enhanced regimes.

The enhancements will take retroactive effect from the year of assessment 2025/26, except for the substantial activities requirement applicable to funds, which has been deferred to year of assessment 2027/28. The IRD has indicated that taxpayers who filed their 2025/26 tax returns without claiming the relevant exemption or concession may amend their returns before the issuance of assessment or lodge an objection within the statutory time limit once an assessment is issued.

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It is expected that the Bill will be passed by the end of 2026 per the government's plan. With the enhanced regimes in place, stakeholders should consider reviewing their existing arrangements to identify potential opportunities and assess their eligibility for the expanded tax benefits. Early preparation and careful planning will be key to making full use of the enhanced concessions while ensuring compliance with the applicable conditions.

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