

# **Proposal to Provide Tax Concession for Family-owned Investment Holding Vehicles**

## **PURPOSE**

This paper sets out the Government's proposal to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to provide tax concession for eligible family-owned investment holding vehicles ("FIHVs") managed by single family offices ("SFOs") in Hong Kong.

## **BACKGROUND**

2. Family offices are private wealth management firms set up by ultra-high-net-worth individuals ("UHNWIs")<sup>1</sup> to generally oversee the day-to-day administration of their family's assets. Attributing to the substantial growth of UHNWIs in Asia, family office business has become an important growth driver to the region's private wealth management business. The industry estimated<sup>2</sup> that there were over 520 000 UHNWIs around the world in 2020, with over 116 000 (22%) of them situated in Asia<sup>3</sup>. The industry also estimated that Hong Kong had over 9 500 UHNWIs in 2020, the second-highest amongst global cities and trailing only behind New York<sup>4</sup>.

3. With our comprehensive financial services platform as well as a liquid capital market that is uniquely connected to the Mainland, Hong Kong is the natural choice for UHNWIs to manage their portfolios in the region. Indeed, the Asset and Wealth Management Activities Survey 2020 published by the Securities and Futures Commission ("SFC") has recorded a 46% year-on-year increase to HK\$2,037 billion (or around US\$263 billion) in 2020 in Hong Kong's private banking and private wealth management business attributed to family offices and private trusts clients.

4. The multiplier effect of family offices could be tremendous in bringing

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<sup>1</sup> UHNWI is generally defined as people with a net worth of at least USD\$30 million in investible assets.

<sup>2</sup> Knight Frank (2021).

<sup>3</sup> It is also projected that the UHNWI population in Asia will exceed 160 000 by 2025.

<sup>4</sup> Wealth X (2021).

businesses to financial and related professional services, as well as channeling capital to our IPO market, venture capital and private philanthropy, etc. To help the industry seize new business opportunities, we have been stepping up our efforts to attract family offices to set up and operate in Hong Kong through (i) creating a facilitating business environment; (ii) providing clarity on the licensing obligations of family offices; and (iii) providing one-stop services for family offices interested in setting up a presence in Hong Kong.

5. When family offices decide where to set up their operations and locate their investments, tax treatment is often a key factor influencing their decisions. As part of the Government's multi-pronged approach to attract family offices to set up in Hong Kong, and in order to provide tax certainty to FIHVs owned by UHNWIs given their different nature and ownership structure in comparison to a fund entity, we plan to introduce a new tax regime for eligible FIHVs managed by eligible SFOs in Hong Kong.

## **LEGISLATIVE PROPOSAL**

6. We propose that, if an FIHV which is managed by an SFO fulfils the criteria set out in paragraphs 7 to 18 below, it would be exempted from the payment of tax in respect of its assessable profits earned from qualifying transactions and incidental transactions (subject to the 5% threshold) (see paragraph 13 below).

### ***Requirements for setting up an FIHV***

7. We propose that an FIHV must fulfill the following conditions to be eligible for the tax exemption –

- (a) the FIHV must be a corporation, partnership, or trust, which is incorporated, registered or established in or outside Hong Kong;
- (b) all the issued shares / interests of the FIHV must be exclusively and beneficially owned by one or more individuals<sup>5</sup> who are

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<sup>5</sup> In case the FIHV only has one beneficial owner, the individual concerned should represent the Single Family which comprises of more than one individuals.

“connected persons” (see paragraph 8 below) of the same family (“Single Family”) directly or indirectly. This requirement shall be stipulated in the articles of association or constitutive documents of the FIHV;

- (c) the assets of the FIHV must be managed by an SFO in Hong Kong (see paragraph 9 below);
- (d) the central management and control (“CMC”) of the FIHV must be exercised in Hong Kong<sup>6</sup>; and
- (e) the FIHV(s) must only serve as an investment vehicle for holding and administering the assets for the Single Family, and must not directly engage in activities for general commercial or industrial purposes<sup>7</sup>.

8. In relation to an individual, a “connected person”<sup>8</sup> would include –

- (a) spouse of the individual;
- (b) lineal descendant<sup>9</sup> of the individual, or spouse of the descendant;
- (c) parent of the individual, or parent of the individual’s spouse;
- (d) grandparent of the individual, or grandparent of the individual’s spouse;

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<sup>6</sup> CMC is a well-established test in common law jurisdictions for determining the residence of corporations, partnerships and trusts. Our proposal is that the FIHV must exercise CMC in Hong Kong to enjoy the tax exemption for profits earned from qualifying transactions. This practice is consistent with other preferential tax regimes including corporate treasury centres, aircraft leasing and ship leasing. Further guidance would be provided in the Departmental Interpretation and Practice Notes on the proposed regime for FIHV to be issued by the Inland Revenue Department (“IRD”).

<sup>7</sup> This requirement aims to reduce the risk of tax abuses by businesses repackaging themselves as FIHVs.

<sup>8</sup> The term “connected person” encompasses specified classes of persons provided for in paragraph 8(a) to (i), the definitions of which can be made reference to sections 2 and 26J of the IRO where applicable.

<sup>9</sup> “Lineal descendant”, in relation to an individual, means the individual’s child, the child of the child and so on.

- (e) sibling of the individual, sibling of the individual's spouse, or spouse of the sibling;
- (f) child<sup>10</sup> of the sibling of the individual, or spouse of the child;
- (g) child of the sibling of the individual's spouse;
- (h) sibling of the individual's parent, or spouse of the sibling; and
- (i) child of the sibling of the individual's parent, or spouse of the child.

### ***Management of assets by SFO***

9. In order to fulfil the policy objective of bringing investment management and related activities to Hong Kong, the assets of the FIHV must be managed by an SFO in Hong Kong. The SFO –

- (a) must be a private company (incorporated in or outside Hong Kong) exercising CMC in Hong Kong;
- (b) must be exclusively and beneficially owned directly or indirectly by the Single Family holding the FIHV; and
- (c) must not provide investment management services to entities other than the FIHV(s) exclusively and beneficially owned by the Single Family.

10. To ensure effective ongoing monitoring and enforcement of the proposed tax regime, we also propose that, the maximum number of FIVs, which are managed by the same SFO and will benefit from the proposed regime, shall not exceed 50. To ensure that sufficient safeguards are in place to prevent potential manipulation and tax abuse, an election mechanism is proposed with design features similar to those of existing preferential tax regimes (e.g. ship

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<sup>10</sup> A "child", in relation to an individual, means (a) a child of the individual or of the individual's spouse or former spouse, whether or not the child was born in wedlock; and (b) includes the adopted or step child of either or both of: (i) the individual; and/or (ii) the individual's spouse or former spouse.

leasing regime). The key features of the proposed election mechanism are –

- (a) a formal election is required;
- (b) the election made by an FIHV should be irrevocable; and
- (c) no annual election should be allowed.

11. We do not plan to cover FIHVs managed by multi-family offices in the scope of our current tax proposal. This is because multi-family offices are independent service providers not exclusively owned by any single family. Multi-family offices may also engage in the provision of investment management services for entities other than the FIHV(s) owned by single families, hence the monitoring of minimum asset threshold (see paragraph 12 below) and core income generating activities (“CIGAs”) by the FIHV(s) (see paragraph 14 below) would be very difficult.

### ***Minimum asset threshold***

12. To ensure that the FIHV is a genuine investment vehicle for UHNWIs, we propose to impose a minimum threshold on the assets under management (“AUM”) of the FIHV, that is, the aggregate average value<sup>11</sup> of assets specified under Schedule 16C to the IRO (“specified assets”) shall be at least HK\$240 million<sup>12</sup> in each of the following family-owned structure –

- (a) a single FIHV which is managed by an SFO in Hong Kong; or

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<sup>11</sup> It is proposed that the average AUM may be calculated by reference to either: (a) a yearly average of the valuation of net assets made at the beginning and end of a year of assessment for which the FIHV claims the tax concession (“the subject year”); or (b) a three-year average of the valuation of net assets made at the end of the subject year, and the other two years immediately before the subject year. If an FIHV is incorporated, registered or established for less than two consecutive years immediately before the subject year, it is allowed to calculate the average AUM by a two-year average of the valuation of net assets made at the end of the subject year, and the other year immediately before the subject year.

<sup>12</sup> The proposed minimum threshold makes reference to the wealth range generally recognised as UHNWIs under the research report titled “Family Wisdom: A Family Office Hub in Hong Kong” issued by the Financial Services Development Council in July 2020.

- (b) multiple FIHVs which are exclusively and beneficially owned by the Single Family directly or indirectly and managed by the same SFO in Hong Kong.

### ***Qualifying transactions of the FIHV***

13. Subject to the fulfillment of conditions above, an FIHV would enjoy profits tax exemption in respect of the following –

- (a) transactions in specified assets (“qualifying transactions”)<sup>13</sup>; and
- (b) transactions incidental to the carrying out of qualifying transactions (“incidental transactions”) subject to a 5% threshold<sup>14</sup>.

The qualifying transactions of an FIHV must be carried out in Hong Kong by or through an SFO, or arranged in Hong Kong by the SFO. In line with the tax treatment under the unified tax regime for funds, we are prepared to allow the FIHV to establish family-owned special purpose entities (“SPEs”) to hold and administer the specified assets.

### ***Substantial activities requirements***

14. In compliance with the latest international tax standards, FIHVs which would benefit from the proposed regime should have carried out their CIGAs in Hong Kong<sup>15</sup>. We propose that, in order for the tax exemption to apply, each

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<sup>13</sup> To reduce the risk of tax evasion by FIHV and SPE(s) established by FIHV for holding and administering its investment in private companies, we propose that the immovable property test, holding period test, control and short-term asset test currently applicable to funds under sections 20AP and 20AQ of the IRO should continue to apply to them.

<sup>14</sup> The FIHV’s trading receipts from incidental transactions must not exceed 5% of the total of the FIHV’s trading receipts from qualifying transactions and incidental transactions in the basis period for the year of assessment. Please refer to sections 20AN(4) and 20AO(2)(e) of the IRO for details.

<sup>15</sup> According to the criteria set out by the Forum on Harmful Tax Practices (“FHTP”) of the OECD, substantial activities requirement must apply to each taxpayer benefiting from a preferential tax regime on an entity basis (i.e. the FIHV in the proposed regime). Outsourcing of CIGAs is permitted by the FHTP provided that the use of outsourcing is not for circumventing the substantial activities requirement. For the purpose of satisfying the substantial activities requirement under the proposed regime, the number of qualified full-

FIHV should have an adequate<sup>16</sup> number of full-time qualified employees and incur an adequate<sup>16</sup> amount of operating expenditure for carrying out the CIGAs<sup>17</sup> in Hong Kong to the satisfaction of the Commissioner of Inland Revenue during the basis period for the year of assessment, including –

- (a) employing not less than two full-time employees in Hong Kong who carry out the activities concerned and have the qualifications necessary for doing so; and
- (b) incurring not less than HK\$2 million operating expenditure in Hong Kong for carrying out the activities concerned.

### ***Loss sustained by FIHV and SPE***

15. We propose to extend the application of the current loss treatment provisions applicable to funds under section 20AU of the IRO to FIHVs and SPEs. In other words, if an FIHV or an SPE is exempted from the payment of tax in respect of its assessable profits for a year of assessment, any loss sustained by the vehicle or entity from certain transactions in the year of assessment is not available for set off against any of its assessable profits for the year or any subsequent year of assessment.

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time employees employed and the amount of operating expenditure incurred by the FIHV, or by the SFO on behalf of the FIHV if the CIGAs are outsourced, must be commensurate with the level of the CIGAs carried out in Hong Kong.

<sup>16</sup> To be eligible for the tax concessions, the FIHV has to demonstrate that the “adequacy test” has been satisfied (i.e. the number of qualified full-time employees working in Hong Kong and the amount of operating expenditure incurred in Hong Kong must be adequate to carry out the CIGAs for the derivation of the income given the tax concessions). For the purpose of applying the “adequacy test”, the totality of the facts of each case would be considered.

Whilst it is not the intent to provide an exhaustive list in this paper, some of the factors to be considered include: (a) types of the assets owned by the FIHV and managed by the SFO; (b) value of the AUM of the FIHV; (c) the types and level of CIGAs undertaken in Hong Kong by the FIHV, or by the SFO on behalf of the FIHV if the CIGAs are outsourced; (d) details of the employees employed in Hong Kong, including their level of experience and qualifications, position held and duties performed; and (e) amount and types of the operating expenditure incurred in Hong Kong.

<sup>17</sup> The CIGAs here refer to the management of assets of an FIHV which includes (a) researching and advising on potential investments to be made for the FIHV; (b) acquiring, holding, managing and disposing of investment for the FIHV; (c) establishment or administration of an SPE for the purpose of holding and administering one or more underlying investments; (d) leasing premises; and (e) entering into contracts, including contracts of employment and contracts for the provision of services.

### ***Anti-avoidance and anti-round tripping provisions***

16. To prevent tax abuse, if the Commissioner of Inland Revenue is satisfied that the main purpose, or one of the main purposes, of the FIHV or the SPE entering into an arrangement is to obtain a tax benefit, the tax exemption would not apply to the FIHV or the SPE concerned.

17. Given the diverse holding structures of FIHV, a single family may hold FIHVs directly or indirectly through resident companies and such companies are likely to be associated with the FIHVs. To address such special features of family office arrangement whilst ensuring that adequate safeguards are in place, modified anti-round tripping provisions would be introduced for the proposed tax regime for FIHVs. We suggest the provisions be modelled on the existing anti-round tripping provisions applicable for funds with two carve-outs: (i) resident individuals; and (ii) resident non-individual entities subject to certain anti-abuse measures, including –

- (a) the entities concerned must be exclusively and beneficially owned by the Single Family directly or indirectly;
- (b) the entities concerned are either (i) passive investment holding vehicles without carrying on other businesses and/or operations; or (ii) an SFO exclusively and beneficially owned by the Single Family (see paragraph 9 above) which does not carry on other businesses or trade other than solely providing services to the FIHV(s) of the Single Family; and
- (c) no arrangement of shifting taxable income from the Single Family or entities controlled by them to an FIHV for obtaining a tax benefit would be allowed. Where there has been a transfer of assets or businesses on an arm's length basis from a person ("the Transferor") carrying on a business in Hong Kong to the FIHV, and the Transferor is chargeable to tax in respect of the assessable profits arising from the transfer, then the FIHV would still be entitled to the tax exemption.

### *Administration of the regime*

18. The IRD is responsible for the administration of the tax regime for FIHVs. To ensure the fulfilment of the eligibility criteria, the FIHV and SFO have to file tax returns to the IRD annually, and keep sufficient records (e.g. significant controllers register, trust register, etc.) on the beneficial owner(s) of the FIHV and the SFO.

### **TIMELINE**

19. It is our plan to introduce an amendment bill into the Legislative Council as soon as practicable. Subject to the legislative process, our plan is to apply the concessionary tax treatment for any year of assessment commencing on or after 1 April 2022.

### **VIEWS SOUGHT AND WAY FORWARD**

20. Please send us your views, if any, on the proposal as set out in paragraphs 7 to 18 above by **8 April 2022** by email to “[fo-consultation@fstb.gov.hk](mailto:fo-consultation@fstb.gov.hk)”. Please mark on the subject line of an email “Proposal to provide tax concession for family-owned investment holding vehicles”. Please also indicate if you do not want your views to be published or if you wish to remain anonymous when your views are published. Unless otherwise specified, all responses will be treated as public information and may be published in the future.

21. The Government will consider the views received in the compilation of an amendment bill for consideration by the Legislative Council.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
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