



cutting through complexity

Taxation of Trusts in Hong Kong

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General Comments On Taxing Trusts In Hong Kong

- There are no express statutory exemptions for trust structures (cf Singapore)
- Hence, trustees must plan their investments to ensure their profits fall within specific exemptions

Four Strategies To Avoid Tax In Hong Kong

- This requires either
 - Avoid being taxable in the first place - ensuring that each individual investment is structured so as to be tax-free, or
 - Using offshore managers and onshore advisers, or
 - Relying on the offshore funds exemption (but this is limited), or
 - Using regulated collective investment vehicles

Some General Points

- A person is taxable if it
 - Carries on business in Hong Kong, either itself or through an agent, *and*
 - Earn profits having a Hong Kong source
- A trustee is taxable on its fees for acting as a trustee
- The taxability of the trust fund's profits are determined as if each trust is a separate taxpayer
- If the trust conducts its activities through underlying companies, then the companies are subject to the normal corporate tax rules in Hong Kong

1. Avoid Being Taxable In The First Place (1)

- Typical scenario – an offshore trust with a liaison / back-office in Hong Kong
- Take care to ensure that the Hong Kong affiliate does not act at the agent of the trustee or PIC in Hong Kong; hence the use of “adviser” companies
- An obvious tax risk arises if the trustee is a Hong Kong based entity
- Failing that, you need to ensure that
 - All transactions are conducted outside Hong Kong, or
 - Profits fall within specific tax exemptions in Hong Kong

What Is Tax-Exempt In Hong Kong? (2)

- Dividend income
- Bank deposit income
- Non bank interest if
 - loan funds are made available to the borrower outside Hong Kong
 - the lender isn't carrying on a money-lending business
- Certain types of bond interest and gains from such bonds (eg, 7+ years tenure)

What Else **Won't** Be Taxed In Hong Kong? (3)

- Rent and gains from foreign real estate
- Capital gains – but don't assume that gains are capital!
- Foreign source profits
 - Profits from trading in offshore listed stocks
 - In other cases, purchase and sale contracts must be negotiated and concluded outside Hong Kong
 - IRD doesn't like to see untaxed profits

What **Will** Be Taxed in Hong Kong? (4)

- Profits from dealings in Hong Kong listed shares earned by a Hong Kong resident
- Interest from a money-lending business conducted in Hong Kong (treasury operations)
 - Possible relaxation in 2015
- Other profits that arise from dealings conducted in Hong Kong
 - OTC transactions
 - Private company shares, bonds & other securities
 - Foreign exchange gains
 - Derivative transactions
 - Strategy here is to have investments managed by someone outside Hong Kong

2. Using An Offshore Manager And Onshore Adviser

- Typical scenario – an offshore trust with a Cayman manager and Hong Kong adviser company
- Take care to ensure that the Hong Kong adviser does not sign contracts in Hong Kong for the trust; otherwise there would be an agency in Hong Kong
- An obvious tax risk arises if the trustee is a Hong Kong based entity
- IRD expects the Hong Kong adviser to be adequately compensated (not just costs plus 5%)

3. Using The Offshore Funds Exemption (1)

- This exemption is available to all *non-residents* who
 - deal in Hong Kong listed shares and financial investments, and
 - deal through a licensed broker/dealer or asset manager
- The exemption will be extended in 2016 to dealings in private company shares, other than
 - in private companies owning real estate in Hong Kong, or
 - otherwise carrying on business in Hong Kong

Using The Offshore Funds Exemption (2)

- The exemption is NOT available if
 - The trustee or underlying company is resident in Hong Kong (incorporated?), or
 - The trustee is de facto controlled by a Hong Kong resident, or
 - The underlying company is 30%+ owned by Hong Kong residents (unless widely held)
- This discourages the use of Hong Kong trustees and companies
- It requires artificial structuring to ensure non-resident status

4. Using A Tax-Exempt Entity

- Collective investment vehicles, such as
 - Mutual funds, unit trusts and limited partnerships
 - Must be registered with the Hong Kong SFC
 - Or, may be registered with a similar offshore regulator, if bona fide intended to be widely-held
 - IRD frowns on real estate holding entities
- A charity is not exempt on ordinary investment income; its business profits are only exempt if earned pursuant to its charitable objects

Reform - What Are We Trying to Achieve

- Encourage the use of Hong Kong trusts
- Encourage the use of Hong Kong trustees
- Encourage the use of Hong Kong companies and directors
- Facilitate the decision making process for fund management in Hong Kong
- Avoid the use of tax haven management structures

Conclusions About Hong Kong

- The tax system discourages the use of Hong Kong based trustees, and Hong Kong incorporated/resident companies – a policy issue
- This seems inconsistent with the Hong Kong government's intention to encourage the use of Hong Kong as a wealth management centre – it forces entities to be formed, and activities to be conducted, overseas
- Our tax system requires piece-meal planning – should Hong Kong have a comprehensive tax exemption (as does Singapore)?

FATCA & Trusts

- Hong Kong has entered into a Model II IGA with the IRS
- Trusts established to hold financial assets must consider their position
- An “account holder” is a US beneficiary
- Discretionary beneficiaries are caught only if they actually receive distributions
- There are de minimis exemptions
- Charities need to ensure they qualify for exemption
- Retirement funds (MPF) are generally exempt
- Private trust companies and underlying entities are caught, but consider use of a sponsor who is a compliant entity
- (These comments are very general only)

OECD's Common Reporting Standard & Trusts

- Hong Kong has committed to the CRS
- Covers companies, trusts and foundations owned by customers
- Generally tied in with FATCA, but note
 - Based on residence of customer
 - No de minimis thresholds
 - Information required is different
 - Trusts are treated differently (CRS focuses on settlor, all beneficiaries or “effective control”; FATCA focuses on persons receiving actual distributions)
 - IT requirements will vary from country to country