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HKCGI Wealth Management Guidance Note (Second Issue) - Hong Kong's tax concession regime for single family offices to enhance competitiveness

Introduction

There is a global competition to attract family offices to establish their operations. Simply put, they represent a significant source of wealth, and their investment activities with the economic multiplier effects contribute to the economies where they establish. For Hong Kong to be competitive in attracting the establishment of family offices, there is a need to provide some tax concessions, a priority matter for the Government.

This guidance note will provide governance professionals with knowledge of Hong Kong's proposed tax concession for single family offices as a centrepiece of the Government's strategy to attract the establishment of family offices in Hong Kong. Hong Kong has many other unique advantages, for example, proximity and support by China, size, variety and depth of the financial market, and its talent pool, including governance professionals. Family offices offer governance professionals opportunities to support establishment in Hong Kong and other governance-required functions.

Background

On 9 December 2022, the Government published in the gazette the 'Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022' (**Bill**). It is anticipated that the Bill will become law soon and affect tax assessments from the 2022/23 tax year. In a nutshell, the Bill seeks to provide tax concessions for single family offices in Hong Kong. As noted, there is a keen global competition for attracting the establishment of family

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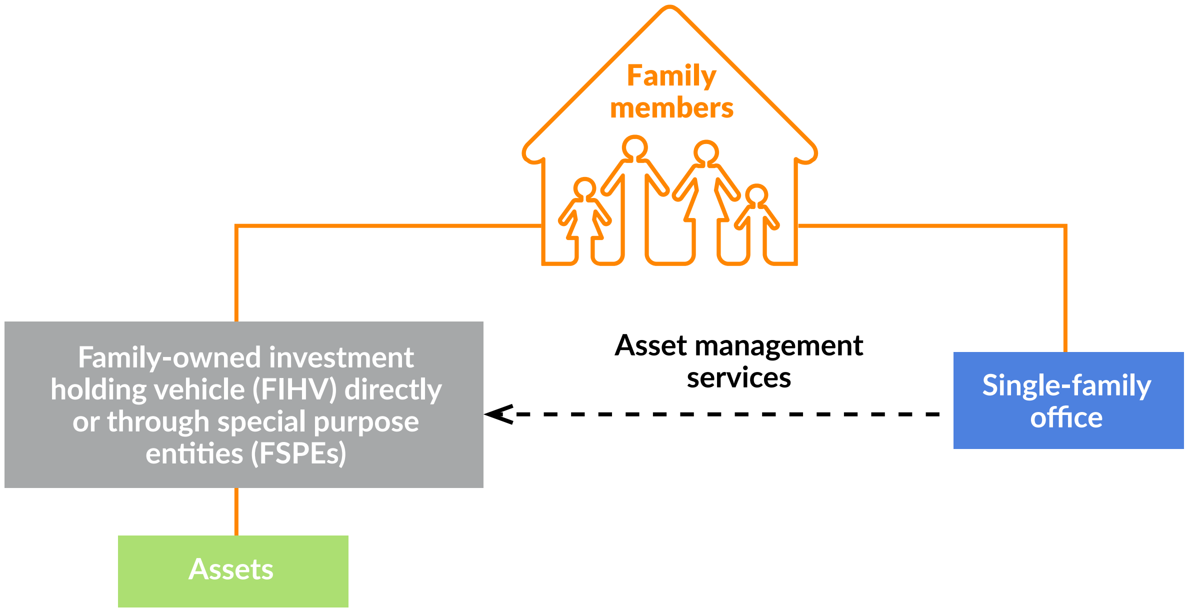
offices, and this guidance note will also provide a high-level comparison with Singapore.

Typical single family office structure

A typical single family office structure contains (1) a family-owned investment holding vehicle (**FIHV**) to hold assets for the family and (2) a separate entity as the family office to manage the assets held by the FIHV. Investment gains usually arise at the FIHV, and these investment gains, before the family office tax concession regime comes into force, would be subject to Hong Kong profits tax to the extent the gains could not be regarded as capital or offshore in nature. These were significant detriments to family offices established in Hong Kong.

A typical single family office structure is illustrated in the diagram below.



Key features of the tax concession for single family office investments in Hong Kong

The Bill is complex to read and this guidance note aims to provide governance professionals with a useful and concise overview of the tax regime for single family offices. The governance professionals should seek professional advice where required.

1. ***Tax concession***
   The Bill proposes a concessionary Hong Kong profits tax rate of 0% to apply to assessable profits derived by 'eligible' FIHVs managed by 'eligible' single family offices (**ESF Offices**) in Hong Kong. FIHVs may establish eligible special purpose entities (**FSPEs**) for holding and administrating FIHVs' assets, and the FSPEs would also qualify for the tax concession.

2. ***Eligible FIHVs***
   An FIHV would be regarded as an 'eligible' FIHV where it satisfies the following conditions:

   - The FIHV is a body of persons, corporate or unincorporated, or a legal arrangement, including a corporation, partnership and trust (including a discretionary trust), established or created in or outside Hong Kong.

   - It only serves as an investment vehicle for holding and administering assets and must not be a business undertaking for general commercial or industrial purposes.

   - Its central management and control (**CMC**) is exercised in Hong Kong.

- At least 95% of its beneficial interest is being held (directly or indirectly) by one or more than one members of a single family [see below].

- It is managed[1] in Hong Kong by an ESF Office [see below]. In this connection, no more than 50 FIHVs can be managed by the same ESF Office, and tax election for concession for its FIHVs is irrevocable.

3. *Members of a single family*

As noted, 95% of the beneficial ownership of an FIHV needs to be held by members of a single family for it to be eligible for tax concession.

In this connection, family members include the spouse[2] (including deceased spouse), parents, grandparents, children (including adopted and stepchildren), grandchildren, siblings (including spouse's siblings) and their spouse, children and other persons as defined under the Bill.

Further, it has been proposed that the extent of beneficial interest that an exempted charity may hold in an FIHV will be expanded so exempted charities like foundations can be admitted as beneficiaries of FIHVs and at the same time benefitting from the proposed tax concessions[3].

4. *ESF Office*

To be an eligible FIHV, the FIHV, apart from its ownership, management and control requirements, must also be managed by an ESF Office, which satisfies the following conditions:

- A private company incorporated in or outside Hong Kong

- CMC in Hong Kong

- At least 95% of its beneficial interest is being held (directly or indirectly) by one or more than one members of a single family.

- At least 75% of the assessable profits arise 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 from the provision of services to specified persons is chargeable to tax in Hong Kong.

5. *Minimum asset threshold*

The aggregate value of specified assets managed by the ESF Office 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.

6. *Substantial activities requirement*

Economic substance in Hong Kong is required to enjoy the tax concession:

- An FIHV is required to carry out its core income-generating activities in Hong Kong

- The proposed minimum requirements for employee and operating expenditures 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

- The outsourcing of the core income-generating activities to the ESF Office is permitted.

1 An FIHV is managed by an ESF Office if the ESF Office carries out the investment activities concerning the FIHV, including conducting research and advising on any potential investments; acquiring, holding and managing or disposing of property; and establishing or administering an FSPE.

2 If a spouse ceases to be a spouse during a year of assessment that begins on or after 1 April 2022, the spouse would still be regarded as a member of the relevant family for the subject year of assessment and the following year of assessment.

3 'Policy Statement on Developing Family Office Businesses in Hong Kong' issued by the Financial Services and the Treasury Bureau of the HKSAR Government dated 24 March 2023

4 For this purpose, the aggregate net asset value of the specified assets (**Aggregate NAV**) at the end of the FIHV's basis period would be considered. If the Aggregate NAV for a year falls below HKD240 million, the Aggregate NAV for the preceding two years would also be considered..

7. ***Qualifying transactions***

Assessable profits derived by an FIHV or FSPE from qualifying transactions in specified assets (e.g., shares, stocks, debentures, futures contracts, foreign exchange contracts and over-the-counter derivative products etc.) and transactions incidental to them (subject to a 5% threshold) are eligible for the concessionary tax rate of 0%[5].

The qualifying transactions must be carried out or arranged in Hong Kong by the ESF Office.

8. ***Anti-avoidance and anti-round-tripping provisions***

The tax concession will not apply 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. That said, 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 Bill also contains anti-round tripping provisions, which are modelled based on the existing requirements applicable for funds under the 'unified fund exemption regime' with certain modifications[6].

9. ***Effective date***

The tax concession will apply from the year of assessment 2022/23 and onwards upon enactment of the Bill into law.

Advantages of the family office regime in Hong Kong

The tax concession would enhance Hong Kong's competitive position compared with Singapore's for setting up a family office. In particular, the family office regime in Hong Kong appears to be more flexible, and it has less stringent requirements regarding fund size, local substance requirements and regulatory approval. The following is a high-level comparison between the proposed Hong Kong tax concession for single family offices and the 'Enhanced Tier Fund Tax Exemption Scheme (13U)' in Singapore:

Item	Proposed Hong Kong tax concession for single family offices	Singapore's Enhanced Tier Fund Tax Exemption Scheme (13U) for funds managed by single family offices (Note 1)
Fund size	HKD240m (without local investment requirement)	Approximately HKD280m (SGD50m), at the time of application, with local investment requirement (i.e., at least 10% of its AUM or SGD10m (whichever is lower) is required to be invested locally in Singapore)
Local substance	• Two full-time qualified employees • Local operating expenditure: HKD2m	• Three investment professionals employed by the family office, at least one of whom is a non-family member • Local business spending at the fund level: - around HKD2.8m (SGD500K); or - around HKD5.6m (SGD1m) if fund size is larger than HKD560m (SGD100m)

5 The proposed scope of qualifying and incidental transactions eligible for the tax concession for a FIHV or FSPE aligns with the current 'unified fund exemption regime' applicable to funds.
For investment in private companies, the 'immovable property test', 'holding period test', 'control test', and 'short-term asset test' under the unified fund exemption regime would also apply to an FIHV or FSPE.

6 Under the unified fund exemption regime, if a resident person 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) certain resident non-individual entities in relation to the relevant family, subject to specific anti-abuse measures.

Regulatory approval	Self-assessment basis; no pre-approval is required. The application of tax concession is independent of the licensing status of the ESF Office.	Approval from the Monetary Authority of Singapore is required. Approval is for the life of the fund.
Note 1: These conditions are applicable where the single family office is exempt from licensing by the Monetary Authority of Singapore.		

Our observations

The family office business represents a fast-growing wealth management segment. Attracting more family offices to set up and operate in Hong Kong will, among other things, create more employment opportunities for related industry professionals, including governance professionals, and foster Hong Kong to become the fund investment hub in the Asia Pacific region. The proposed Hong Kong tax concession for single family offices would encourage more family offices to establish a presence and manage their investments in Hong Kong, and be competitive with other jurisdictions, including Singapore.

As the Bill is still being passed, to further enhance the attractiveness of the family office tax concession in Hong Kong, there have been calls on the Government to consider refining the Bill in the following areas:

- Allowing for multi-family offices/lowering the 95% family-owned requirement.
- Removing the CMC requirement for FIHVs and ESF Offices (while maintaining the substantial activities requirement) to address the situation where it might be impractical for overseas-based families to exercise the highest level of control of the business of their FIHVs and ESF Offices in Hong Kong.
- Broadening the scope of qualifying transactions to cover digital assets, antiques, art pieces, wine, etc., which are commonly invested by family offices but not included in the current scope of qualifying transactions provided in the Bill.
- Introducing tax concessions to ESF Offices comparable to or more attractive than the similar regimes in Singapore, such as tax exemption or half-rate tax concession for their income derived from providing services to FIHVs.

Governance professionals should closely monitor the development of the Bill and the opportunities they bring. Please seek professional advice where there is a desire to seek to establish a single family office, as appropriate.