

# Bill on profits tax concession for family-owned investment holding vehicles

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Issue 17

## In brief

Following the industry consultation from March to April 2022 on a proposal for Hong Kong's family office tax concession regime<sup>1</sup>, the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022<sup>2</sup> (Bill) was gazetted on 9 December 2022.

The Bill seeks to provide profits tax concession for an eligible family-owned investment holding vehicle (FIHV) managed by an eligible single family office (ESF Office) in Hong Kong, such that the FIHV's assessable profits earned from qualifying transactions and incidental transactions (the latter being subject to a 5% threshold) would be subject to a 0% profits tax rate. The tax concession will take retrospective effect from the year of assessment commencing on 1 April 2022.

## In detail

### Eligible criteria for an FIHV

Requirements	
1. Structure	The FIHV must be an entity (established or created in or outside Hong Kong) that is not a business undertaking for general commercial or industrial purposes. Entity includes a corporation, partnership and trust (including a discretionary trust as mentioned in the Legislative Council Brief).
2. Ownership	At least 95%, in aggregate, of the beneficial interest (whether direct or indirect) in the FIHV must be, at all times during the basis period for the year of assessment, held by one or more than one member of a single family <sup>3</sup> .
3. Central management and control (CMC)	<p>The FIHV must, at all times during the basis period for the year of assessment, exercise CMC in Hong Kong.</p> <p>As elaborated in the Legislative Council Brief, in general, if CMC of a company is exercised by the directors in board meetings, the relevant locality is where those meetings are held. However, the place of board meetings may not be conclusive. The Commissioner of Inland Revenue would also consider other factors, including the location where the high-level decisions (that set the FIHV's investment strategy and determine the direction of its operations and the types of investment) were made and approved, and the location where the day-to-day activities necessary for preparing and making those decisions were undertaken.</p>
4. Management of FIHV	<p>The FIHV must be managed in Hong Kong by an ESF Office of the family to which the FIHV is related and the minimum asset threshold must be fulfilled. An ESF Office:</p> <p>(a) must be a private company (incorporated in or outside Hong Kong) exercising CMC in Hong Kong;</p>

(Cont'd)	Requirements
	<p>(b) must have, at all times during the basis period for the year of assessment, at least 95%, in aggregate, of its beneficial interest being held (directly or indirectly) by one or more than one member of the family;</p> <p>(c) must provide services to specified persons of the family (including the FIHV and members of the family) and the fees for the provision of those services are chargeable to Hong Kong profits tax; and</p> <p>(d) must fulfill the safe harbour rule whereby at least 75% of the ESF Office's assessable profits should arise from the services provided to specified persons of the family.</p> <p>To ensure effective ongoing monitoring and enforcement of the proposed tax concession regime, the maximum number of FIHVs which are managed by the same ESF Office and may benefit from the proposed tax regime shall not exceed 50. An irrevocable election is required to be made by the FIHV in order to enjoy the proposed tax concession.</p> <p>In terms of the minimum asset threshold, the aggregate value of the specified assets under Schedule 16C to the Inland Revenue Ordinance ("Specified Assets") managed by the ESF Office for an FIHV (or multiple FIHVs) of the relevant family must be at least HK\$240 million as at the end of any one of the basis periods for the current year and the preceding two years.</p>
5. Substantial activities requirement	<p>The FIHV must carry out its investment activities in Hong Kong and fulfill the substantial activities requirement. Subject to the "adequacy" test, at a minimum, an FIHV is required to have:</p> <p>(a) not less than two full-time employees in Hong Kong who have the qualifications necessary for carrying out the required investment activities; and</p> <p>(b) not less than HK\$2 million operating expenditure incurred in Hong Kong for carrying out the required investment activities.</p> <p>Outsourcing of investment activities to an ESF Office is permitted provided that the use of outsourcing is not for circumventing the substantial activities requirement.</p>

**Our observations:** The 95% beneficial interest ownership requirement for both the FIHV and ESF Office provides flexibility to allow non-family members (such as the employees of the ESF Office) to hold a minority interest in the FIHV and ESF Office. The 75% safe harbour rule for the ESF Office also provides additional safeguard to the FIHV such that it would not be prevented from enjoying the profits tax concessionary treatment even if the ESF Office derives income from sources in Hong Kong other than that from services provided to specified persons of the family (e.g. co-investment vehicles). The Legislative Council Brief has also clarified that an FIHV can be in the form of a discretionary trust, and can be held by only one member of a single family, which provide flexibility to the legal form of an FIHV and the number of family member(s) in an FIHV.

## Qualifying transactions and incidental transactions

Qualifying transactions refer to transactions in Specified Assets, and incidental transactions refer to transactions incidental to the carrying out of qualifying transactions subject to a 5% threshold. The qualifying transactions must be carried out in Hong Kong by or through an ESF Office of the relevant family, or arranged in Hong Kong by the ESF Office.

In line with the tax treatment under the unified tax exemption regime for funds ("UFR"), an FIHV is allowed to establish special purpose entities ("FSPEs"), whether established or created in or outside Hong Kong, for holding and administering the FIHV's assets and such FSPEs will also be eligible for the proposed tax concession to the extent which corresponds to the percentage of beneficial interest of the FIHV in the FSPEs. For investment in private companies, the immovable property test, holding period test and short-term asset test under the UFR will apply to both FIHVs and FSPEs.

**Our observations:** The permissible investment list is the same as that of the UFR, which means that an FIHV that derives Hong Kong sourced interest income from investment in debt instruments would need to meet the 5% threshold in order for the interest income to be eligible for profits tax concessionary treatment.

## Anti-avoidance provisions

The proposed tax concession is subject to certain anti-avoidance and anti-round tripping provisions modelled on the existing “deeming provisions” under the UFR with a few carve-outs, namely (i) Hong Kong resident individuals; (ii) Hong Kong resident entities that are passive investment holding vehicles, subject to meeting certain conditions; and (iii) an ESF Office.

On the other hand, it is noteworthy that the proposed tax concession will not apply if (i) the main purpose, or one of the main purposes of an FIHV or FSPE in entering into an arrangement; or (ii) the main purpose, or one of the main purposes of a person who is carrying on a business in Hong Kong making a transfer of any asset or business to the FIHV or FSPE, is to obtain a tax benefit, whether for the FIHV or the FSPE or another person or entity, unless the transfer is carried out on an arm’s length basis and the transferor is chargeable to tax in respect of the assessable profits arising from the transfer.

**Our observations:** *The carve-outs for the “deeming provisions” increase the attractiveness of the proposed tax concession to Hong Kong based family offices. However, clarification from the Hong Kong Government is required as to whether the anti-avoidance provisions would be triggered in a situation where a Hong Kong taxpayer transfers assets or business to an FIHV but the profit arising from such transfer is not chargeable to Hong Kong profits tax (e.g. due to such profits being capital in nature).*

## Interaction with foreign-sourced income exemption regime

By being added to the list of concession provisions, similar to other existing preferential tax regimes with substantial activities requirement, foreign-sourced interest, dividends and disposal gains from sale of equity interests derived from or incidental to the carrying out of the profit producing activities under the proposed tax concession for FIHV will fall outside the scope of ‘specified foreign-sourced income’ under the refined foreign-sourced income exemption regime.

## Legislative timeline

The Bill will be introduced into the Legislative Council on 14 December 2022. It will be subject to the scrutiny and approval of the Legislative Council before being enacted into law.

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## The takeaway

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We are pleased to see that the Bill has taken on board certain industry comments, such as the 95% beneficial interest ownership requirement for both FIHV and ESF Office, the 75% safe harbour rule for ESF Office, the clarification that an FIHV can be in the form of a discretionary trust, and can be held by only one member of a single family, etc. We believe that the introduction of the tax concession for FIHV would attract more family offices to set up and run their operations in Hong Kong, which will enrich Hong Kong’s asset and wealth management ecosystem.

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## Endnotes

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1. The news flash on the industry consultation can be accessed via this link:  
<https://www.pwchk.com/en/hk-tax-news/2022q1/hongkongtax-news-mar2022-1.pdf>
2. The Bill and the Legislative Council Brief on the Bill can be accessed via these links:  
<https://www.gld.gov.hk/egazette/pdf/20222649/es32022264926.pdf>  
[https://www.legco.gov.hk/yr2022/english/brief/asst3182c\\_20221207-e.pdf](https://www.legco.gov.hk/yr2022/english/brief/asst3182c_20221207-e.pdf)
3. A member of a single family is defined in the Bill which broadly covers, whether alive or deceased, (i) the member concerned; (ii) his / her spouse; (iii) their parents (including parents of their parents and so on); (iv) siblings and siblings’ spouse of the member concerned, his / her spouse and their parents; (v) children (including children of these children and so on) of the member concerned and the aforesaid siblings (whether or not the children were born in wedlock, and including adopted children and step children); and (vi) the spouse of these children etc. If a person ceases to be a spouse during a year of assessment, this person is still regarded as a family member for the subject year and the year immediately after the subject year (but not for any subsequent years).

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## Let's talk

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For a deeper discussion of how this impacts your business, please contact:

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