

**For discussion
on 4 April 2022**

Legislative Council Panel on Financial Affairs

Proposed Tax Concession for Family Offices

PURPOSE

This paper briefs Members on the legislative proposals to provide tax concession for eligible family-owned investment holding vehicles (“FIHVs”) managed by single family offices (“SFOs”) in Hong Kong with a view to further attracting family offices to establish a presence in Hong Kong.

BACKGROUND

2. Asset and wealth management is one of the key pillars of our financial services industry. To strengthen our position as a premier asset and wealth management hub, the Government has completed a three-step strategy in recent years, including the introduction of the limited partnership fund regime, tax concessions for carried interest distributed by private equity funds, and establishment of a fund re-domiciliation mechanism to attract foreign funds to domicile in Hong Kong. Besides, subsidies are also provided for open-ended fund companies set up in or re-domiciled to Hong Kong as well as real estate investment trusts authorised and listed in Hong Kong.

3. Family offices are private wealth management firms set up by ultra-high-net-worth individuals (“UHNWIs”)¹ 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 of the region’s private wealth management business. The industry estimated² that there were over 610 000 UHNWIs around the world in 2021, with over

¹ UHNWI is generally defined as people with a net worth of at least US\$30 million in investible assets.

² Knight Frank (2022).

169 000 (27%) of them situated in Asia. 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 York³.

4. 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. The multiplier effect of family offices could be tremendous in bringing 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 also been stepping up our efforts to attract family offices to set up and operate in Hong Kong through a multi-pronged approach⁴.

LEGISLATIVE PROPOSAL

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. In order to attract family offices to set up a presence in Hong Kong, and to provide tax certainty to FIHVs owned by UHNWIs given their different nature and ownership structure⁵, the Financial Secretary announced in the 2022-23 Budget Speech that we will provide tax concession for eligible family investment management entities (i.e. FIHVs) managed by SFOs. A task force, led by the Financial Services and the Treasury Bureau (“FSTB”) and comprising members from the Inland Revenue Department (“IRD”), Hong Kong Monetary Authority (“HKMA”) and SFC, has examined the tax concession proposal and launched an

³ Wealth X (2021).

⁴ They include (i) creating a facilitating business environment through the concerted efforts of our regulators and market players; (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 by establishing a dedicated team under Invest Hong Kong.

⁵ While the structure of family offices may vary, typically, a family would establish an investment holding vehicle (i.e. the FIHV) to hold the assets for the family and a separate entity (i.e. the SFO) to manage the assets held by the investment holding vehicle. Investment gains thus typically arise at the FIHV(s).

industry consultation in March 2022.

6. We propose that, if an FIHV which is managed by an SFO fulfils the criteria set out in paragraphs 7 to 17 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 12 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 individuals⁶ who are “connected persons⁷” 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 8 below);
- (d) the central management and control (“CMC”) of the FIHV must be exercised in Hong Kong⁸; and

⁶ Whilst a Single Family should comprise more than one individual, it is not uncommon for an FIHV to be held by one of the family members exclusively and beneficially. Provided that the beneficial owner of the FIHV is a connected person of the family and other conditions are met, the FIHV will still be entitled to the tax concessions under the proposed regime.

⁷ Broadly speaking, “connected person” of a Single Family under the proposed regime will include specified classes of persons in connection with the individual such as the individual’s spouse, lineal descendants, parents, grandparents, and siblings, as well as child of the individual’s siblings.

⁸ 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 tax exemption. This practice is consistent with other preferential tax regimes including corporate treasury centres, aircraft leasing and ship leasing.

- (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 purposes⁹.

Management of assets by SFO

8. 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.

9. To ensure effective ongoing monitoring and enforcement of the proposed tax regime, we also propose that, the maximum number of FIHVs, 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 regimes¹⁰.

10. We do not plan to cover FIHVs managed by multi-family offices (“MFOs”) under our current tax proposal. This is because MFOs are generally independent service providers not exclusively owned by any single family. MFOs may also engage in the provision of investment management services for

⁹ This requirement aims to reduce the risk of tax abuses by businesses repackaging themselves as FIHVs.

¹⁰ 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.

FIHV(s) owned by different families as well as other investment entities. As such, there are practical difficulties in allowing the combined assessment of aggregate average value of specified assets of multiple FIHVs managed by the same SFO in Hong Kong (see paragraph 11 below); and outsourcing of the FIHV’s core income generating activities (“CIGAs”) to the SFO (see paragraph 13 below) under the proposed tax regime. We may not be able to ascertain the fulfillment of minimum asset threshold requirement by multiple FIHVs managed by MFOs. Given an MFO is unlikely to be exclusively and beneficially owned by the Single Family holding the FIHVs, it is doubtful whether the FIHVs could monitor the CIGAs outsourced to MFOs. The latter requirement is subject to the scrutiny of the Forum on Harmful Tax Practices of the Organisation for Economic Co-operation and Development.

Minimum asset threshold

11. 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 value¹¹ of assets specified under Schedule 16C to the Inland Revenue Ordinance (“IRO”) (“specified assets”) shall be at least HK\$240 million¹² in each of the following family-owned structure –

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

¹¹ 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.

¹² 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.

Qualifying transactions of the FIHV

12. 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”)¹³; and
- (b) transactions incidental to the carrying out of qualifying transactions (“incidental transactions”) subject to a 5% threshold¹⁴.

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 privately offered funds, we also propose to allow the FIHV to establish family-owned special purpose entities (“SPEs”) to hold and administer the specified assets.

Substantial activities requirements

13. 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. We propose that, in order for the tax exemption to apply, each FIHV should have an adequate number of full-time qualified employees and incur an adequate amount of operating expenditure for carrying out the CIGAs¹⁵ in Hong Kong to the satisfaction of the Commissioner of Inland Revenue during the

¹³ 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 should continue to apply to them.

¹⁴ 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.

¹⁵ 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.

basis period for the year of assessment¹⁶, 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

14. We propose to extend the application of the current loss treatment provisions applicable to funds 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.

Anti-avoidance and anti-round tripping provisions

15. 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.

16. 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. Therefore, they might be caught under the current anti-round tripping provisions. 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-

¹⁶ Outsourcing of CIGAs to the SFO is permitted 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-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.

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 8 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

17. 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.

FINANCIAL IMPLICATIONS

18. The proposal would help attract more family offices to set up and operate in Hong Kong, thereby generating more demand for investment management and other related professional services, including financial, legal, and accounting

services. The proposal would also expand the funding pool in Hong Kong and create business opportunities for the financial sector. It would be difficult to estimate the revenue forgone arising from the tax concession proposal as the proposal intends to attract family offices which otherwise would not be set up in Hong Kong, since FIHVs are often set up and operated offshore. It is possible that the tax revenue forgone for granting tax concession to qualifying transactions of FIHVs may be offset partly by the revenue generated from an increase in business activities through the setting up of family offices in Hong Kong.

WAY FORWARD

19. We are formulating the legislative proposals concerned and our target is to introduce the amendment bill into the Legislative Council (“LegCo”) in the second-half of 2022. Subject to the passage of the amendment bill by LegCo, the tax concession treatment will apply for any years of assessment commencing on or after 1 April 2022.

ADVICE SOUGHT

20. Members are invited to comment on the proposal as set out in paragraphs 7 to 17 above.

Financial Services Branch
Financial Services and the Treasury Bureau
March 2022