For discussion
on 2 March 2026

Legislative Council Panel on Financial Affairs

Enhancements to Preferential Tax Regimes for Funds, Family-owned Investment Holding Vehicles and Carried Interest

PURPOSE

This paper briefs Members on the legislative proposal to amend the Inland Revenue Ordinance (Cap. 112, "IRO") to enhance the preferential tax regimes for privately-offered funds, family-owned investment holding vehicles ("FIHVs") managed by eligible single family offices ("FOs") and carried interest, with a view to attracting more funds and family offices to establish a presence in Hong Kong.

BACKGROUND

2. Hong Kong is an international asset and wealth management centre, with assets under management reaching HK35.1 trillion at end-2024. As Asia's largest hedge fund hub and cross-border wealth management centre, Hong Kong ranks first globally in the "investment management" sector under the Global Financial Centres Index.

3. The Government is committed to reinforcing our competitiveness as the premier asset and wealth management centre in the region, including a facilitative tax environment to attract more funds and family offices to set up and operate in Hong Kong. Since 2019, we have introduced three sets of preferential tax regimes with the aim of facilitating the development of the asset and wealth management ("WAM") industry, namely –

(a) the Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Ordinance 2019, which came into operation in April 2019, to provide profits tax exemption for privately-offered funds, regardless of their structure, size and location of central management and control (hereinafter referred to as the unified tax regime for funds or "UFR", given its coverage of both onshore

and offshore funds);

(b) the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021, which came into operation in May 2021, to provide profits tax and salaries tax concession for eligible carried interest; and

(c) the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Ordinance 2023, which came into operation in May 2023, to provide profits tax concession for eligible FIHVs managed by eligible single FOs in Hong Kong.

4. Tax treatment is often cited as a key factor considered by investors and asset managers when deciding where to locate their investment operations. The aforementioned preferential tax regimes for the WAM industry have been very well-received since introduction. The Government has been maintaining communication with the industry on the implementation of the preferential tax regimes, with a view to further enhancing the attractiveness and competitiveness of the tax regimes.

5. In this connection, the Financial Services and the Treasury Bureau ("FSTB") has conducted a review on the preferential tax regimes together with the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission and the Inland Revenue Department ("IRD") and in consultation with the industry, including through industry consultation from November 2024 to January 2025 and further engagement sessions in June 2025. Having considered the views received, we have formulated the following enhancement proposals to the tax regimes.

ENHANCEMENT PROPOSALS

Proposed enhancements to the UFR

Definition of "fund"

6. Currently, under the UFR, the definition of "fund" models on the definition of "collective investment scheme" under the Securities and Futures Ordinance (which includes that the relevant contributions should be pooled). "Funds-of-one" generally

do not satisfy this definition and are not regarded as funds[1]. To facilitate the usage of the tax regime by an expanded scope of funds and to attract sizeable single investors, we propose to expand the definition of "fund" to cover the following fund structures, subject to anti-avoidance measures:

(a) pension funds;

(b) endowment funds, covering charitable entities that are exempt from tax under section 88 of the IRO;

(c) a fund with a governmental entity or a central bank or an international organisation[2] as its sole investor; and

(d) an arrangement with only one investor and with the value of qualifying investments (i.e. classes of assets specified in Schedule 16C to the IRO) managed not less than $240 million, provided that the investor does not have day-to-day control over the management of the property.

In particular, we propose covering certain types of "fund-of-one" arrangements at (c) and (d) above, taking account of the common practice for institutional or ultra-high-net-worth investors to have bespoke arrangements of wholly-owned funds to cater for their investment needs. We also propose that all the above newly scoped-in funds at (a) to (d) above, as well as sovereign wealth funds (hereinafter referred to as "excepted funds" collectively) do not need to be managed by a specified person[3].

7. To provide clarity for the industry and for the avoidance of doubt, we also propose setting out explicitly in the legislation that transacting in or deriving profits from qualifying investments will not by itself render an entity to be regarded as a business undertaking for general commercial or industrial purposes (otherwise, it

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1 Notwithstanding that sovereign wealth funds do not satisfy the definition of "collective investment scheme", the relevant legislation provides that sovereign wealth funds are also funds.

2 International organisation refers to the one that is entitled to a privilege or immunity under an order made under section 3 of the International Organizations (Privileges and Immunities) Ordinance (Cap. 558).

3 Under section 20AN(6) of the IRO, specified person means a corporation licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on, or an authorized financial institution registered under that Part for carrying on, a business in any regulated activity as defined by Part 1 of Schedule 5 to that Ordinance.

would have caused the entity to be regarded as not a fund[4] and ineligible for tax exemption). If the entity is an open-ended fund company ("OFC"), such carve-out will further apply to its transactions in non-qualifying investments and activities for deriving profits therefrom, because OFCs are also tax-exempt for profits derived from non-qualifying investments.

Qualifying investments

8. We propose expanding the scope of qualifying investments to cover immovable property situated outside Hong Kong, emission derivatives/emission allowance and carbon credits, insurance-linked securities, equity interests in non-corporate private entities[5], loans (including private credit investments, same for below), digital assets (but excluding a cryptographically secured digital representation which provides a holder with an interest in any underlying asset other than qualifying investments[6]), precious metals, and specified commodities (i.e. those in connection with and incidental to the trading of over-the-counter ("OTC") derivative products or futures contracts[7]).

9. We also propose a technical amendment on the definition of "private company" (currently, certain investments in private companies are qualifying investments), such that it covers companies of which the shares or debentures are ***not traded*** on any stock exchange ***at the time when*** an income eligible for the profits tax exemption is derived by the fund or SPE, so as to include into qualifying investments the investments in those private companies that were once listed.

Profits eligible for profits tax exemption

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4 Currently, section 20AM(6) of the IRO provides that a business undertaking for general commercial or industrial purposes is not a fund; whereas section 20AM(7) of the IRO provides that a business undertaking for general commercial or industrial purposes includes a business undertaking that directly engages in various activities such as purchase and sale of assets and money lending.

5 E.g. business trusts, private trusts, partnerships, limited liability companies, Tokumei Kumiai and Tokutei Mokuteki Kaisha.

6 In order to adopt a look-through approach and avoid tax abuse (e.g. tokens with real estate in Hong Kong as underlying assets).

7 Currently, OTC derivative products and futures contracts (including those of commodities) are already qualifying investments. The objective of scoping in these specified types of commodities is to cater for the situation where the fund is required to undertake physical settlement in respect of derivative products. As such, it has to be subject to the condition that the trade volume of those commodities traded by the fund or specified purpose entity ("SPE") in that basis period does not exceed 15% of the total trade volume of those commodities and related commodity derivatives traded by the fund or SPE in that basis period.

10. Currently, a fund (or its SPE) may enjoy profits tax exemption on its profits from transactions in qualifying investments ("qualifying transactions") and those transactions incidental to the carrying out qualifying transactions ("incidental transactions") (subject to a 5% cap[8]). To provide for more flexibility for funds and SPEs on deriving profits (say, through interest income) from qualifying investment, we propose including all profits derived by funds and SPEs from qualifying investments as profits eligible for the tax exemption, subject to fulfilment of specified conditions. In other words, the 5% threshold requirement for incidental transactions would be removed.

11. On the other hand, to enhance tax certainty and avoid disputes, an exclusion list would be introduced whereby income specified in the list will not qualify for the tax exemption. For example, income derived from private companies which engage in trading or development of immovable properties in Hong Kong[9] would be covered in the exclusion list. The exclusion list may be updated from time to time by the Commissioner of Inland Revenue by notice published in the Gazette.

Treatment of SPEs

12. Currently, the extent of tax exemption for a fund's SPE is equal to the percentage of the fund's ownership in the SPE. Taking account of industry's feedback that the fund's beneficial interests in the SPE can vary widely in real-world co-investment arrangements, we propose granting full tax exemption to a fund's SPE regardless of the extent of the fund's ownership, subject to the same anti-round tripping provisions applicable to funds[10]. Should the anti-round tripping provisions be triggered for any co-investor of the SPE, the co-investor will be subject to profits tax in respect of their share of profits derived from the SPE from qualifying investments.

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8 The trading receipts from the incidental transactions should not exceed 5% of the total trading receipts from the qualifying transactions and incidental transactions.

9 Income derived from an investment in an entity that engages in a regular business other than property trading but has carried out a one-off property trading transaction which is an adventure in the nature of trade may still qualify for the tax exemption. This aligns with the Tax Certainty Enhancement Scheme whereby an investee entity that engages in a regular business other than property trading but has carried out a one-off property trading transaction which is an adventure in the nature of trade would not be regarded as an excluded entity.

10 Both the existing general anti-round tripping provisions, and the proposed new specific anti-round tripping provisions in relation to loans (see paragraph 16 below), are proposed to apply to SPEs in a similar manner.

13. Separately, the industry has expressed concerns that the existing definition of SPE does not cater for all the activities performed by an SPE. For instance, an SPE may carry out financing activities in relation to investments to be acquired by it. We therefore propose expanding the scope of SPEs' activities to cover the acquisition, holding, administering and disposal of investee private companies and/or another SPE and activities incidental to those activities.

Tests applicable to transactions in private companies

14. The UFR features immovable property test, holding period test, control test and short-term asset test[11] in relation to a fund or SPE's investment in shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a private company to avoid tax abuse. In view of the proposed inclusion of loans, as well as equity interests in non-corporate private entities, as qualifying investments (see paragraph 8 above), we propose adjusting the scope of the four tests to ***equity*** investment/interest in private companies and non-corporate private entities (vis-à-vis the current rule of investments in private companies in general, which include both equity and debt investments).

Anti-round tripping

15. To facilitate resident investors' investment in UFR funds, we propose relaxing the anti-round tripping provisions by adopting the exclusions under the tax concession regime for FIHVs. Specifically, the following persons (investors) would be excluded from the application of the anti-round tripping provisions –

(a) a resident person who is a natural person;

(b) a resident person who is a fund exempt from the payment of tax under the UFR ("an exempted fund");

(c) a resident person who is not chargeable to profits tax or whose profits derived from qualifying investments would have not been included in the person's assessable profits if the assets had been held, or the transactions in those assets had been undertaken, directly by the person in the same manner as that of the fund ("an exempted person"); and

[11] As detailed in sections 20AP and 20AQ of the IRO.

(d) a resident person being an entity that –

(i) is not a business undertaking for general commercial or industrial purpose;

(ii) does not carry on any trade or business in Hong Kong;

(iii) a certain percentage of direct or indirect beneficial interest of which was owned by one or more than one resident individuals, exempted funds, exempted persons or non-residents; and

(iv) which are interposed between the resident individuals, exempted funds, exempted persons or non-residents and the fund.

16. Separately, in light of the proposed inclusion of loans as qualifying investments, we propose to introduce specific anti-round tripping provisions against financial institutions, insurance companies or persons carrying on a money lending business or an intragroup financing business in respect of profits derived by the fund from loans[12].

Tax reporting and substantial activities requirement

17. For the purposes of effective regulation and meeting the international standards for tax transparency, we propose implementing a tax reporting mechanism for funds (and their SPEs if any) benefiting from the enhanced UFR, under which their fund managers or authorized representatives are required to provide certain accounting data of the funds and SPEs concerned, as well as information showing that the tax exemption conditions and substantial activities requirements are satisfied. When formulating the details of the tax reporting mechanism, the Government will take into consideration the industry's views and strive to minimise the compliance burden on funds and SPEs.

18. In line with international tax standards against harmful tax practices, we also propose stipulating substantial activities requirements for funds in terms of local employment and spending, similar to the requirements in the tax concession regime for

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[12] Specifically, if a financial institution, insurance company or person carrying on a money lending business or an intragroup financing business–

(a) has 20% or more beneficial interest in a fund (or any percentage if the fund is an associate of the financial institution, insurance company or person carrying on a money lending business or an intragroup financing business); or

(b) has control or significant influence over a fund,

the relevant institution will be deemed to have derived assessable profits in respect of profits derived by the fund from loans.

FIHVs. The proposed thresholds are –

(a) the average number of qualified employees is adequate in the opinion of the Commissioner of Inland Revenue and is in any event not less than 2; and

(b) the total amount of annual operating expenditure incurred in Hong Kong is adequate in the opinion of the Commissioner of Inland Revenue and is in any event not less than HK$2 million.

Proposed enhancements to the tax regime for FIHVs

19. As the tax concession regime for FIHVs is largely modelled on the UFR, similar enhancements for the tax regime for FIHVs in the following aspects will be introduced –

(a) qualifying investments (see paragraphs 8 to 9 above);

(b) profits eligible for profits tax concession (see paragraphs 10 to 11 above);

(c) treatment of family-owned special purpose entities ("FSPEs") (see paragraphs 12 to 13 above);

(d) tests applicable to an FIHV/FSPE's transactions in private companies (see paragraph 14 above); and

(e) specific anti-round tripping provisions against financial institutions, insurance companies or persons carrying on a money lending business or an intragroup financing business in respect of profits derived by the FIHV from loans (see paragraph 16 above).

Proposed enhancements to the tax regime for carried interest

Certification requirement for funds

20. Currently, under the tax concession regime for eligible carried interest, a fund must go through a certification process implemented by the HKMA. We propose removing the HKMA's certification requirement to streamline the implementation

process.

Qualifying payers of eligible carried interest

21. Under the current tax regime, carried interest eligible for profits tax concession should be received from a "qualifying payer", which includes a certified investment fund and the associated corporation/associated partnership of the certified investment fund. To better align the tax concession regime with market practice, we propose expanding the coverage of "associate" so that entities within the same group (regardless of their legal forms) will be covered by the definition of "qualifying payer".

Hurdle rate

22. According to the industry's feedback, certain start-up funds or angel funds may not specify a specific hurdle rate[13] under the constitutive documents of the funds, and uncertainty would arise as to whether distributions to qualifying persons would be eligible carried interest under the tax concession regime. To provide further tax certainty, we propose removing the reference to a hurdle rate in defining eligible carried interest under the tax regime.

Transactions giving rise to eligible carried interest

23. We propose to expand the scope of transactions giving rise to eligible carried interest beyond typical private equity investments to cover other qualifying transactions such that fund managers of all types of tax-exempt funds and their employees can enjoy carried interest tax concessions. Specifically, the sources of profits of a fund which may give rise to eligible carried interest include –

(a) profits which are exempt from payment of tax under the UFR;

(b) profits which are not chargeable to tax in Hong Kong for reasons other than exemption under the UFR (e.g. offshore income); and

[13] As defined in section 3 of Schedule 16D to the IRO, eligible carried interest is a sum received by, accrued to, to a person by way of profit-related return from the provision of investment management services by the person for a fund. Generally, the sum is to be received or accrued after the payment of a return on investments in the fund subject to the fulfilment of the hurdle rate for the fund. Hurdle rate is defined to mean a preferred rate of return on investments in the fund which is stipulated in the agreement for governing the operation of the fund.

(c) a fund's other taxable profits.

Definition of "qualifying person"

24. Under the current tax regime, a "qualifying person" can receive and accrue eligible carried interest from a qualifying payer. In light of the expanded scope of funds under the UFR, we also propose to refine the definition of "qualifying person" to cover unlicensed fund managers of excepted funds under the UFR.

Payment of eligible carried interest to qualifying employees

25. In order to accommodate different possible distribution arrangements of carried interest, we propose removing the requirement that eligible carried interest has to be "paid through the qualifying person", and to provide tax exemption for cases where the carried interest is received by a personal investment company on behalf of qualifying employees[14].

26. We also propose broadening the scope of "associate" by adopting the reference to "closely related entity", consistent with the proposed modification to the definition of "qualifying payer" (paragraph 21 above) so that an individual employed by entities within the same group (regardless of their legal forms) could meet the definition of "qualifying employee".

FINANCIAL AND ECONOMIC IMPLICATIONS

27. By expanding the range of eligible funds and qualifying investments of the preferential tax regimes, the proposed enhancements seek to attract more funds and family offices to set up and operate in Hong Kong, reinforcing Hong Kong's position as a leading asset and wealth management hub. Widening the definition of funds to cover specific types of fund-of-one structures, including those set up by international organisations such as the Asian Infrastructure Investment Bank ("AIIB"), complements the Government's objective to attract sizable asset owners to set up and manage funds in Hong Kong[15]. Moreover, the inclusion of private credit investments as qualifying

[14] "Qualifying employees" are employed by a "qualifying person" (or its associated entity in Hong Kong) and provide investment management services in Hong Kong for the qualifying person.

[15] AIIB, which invested more than USD60 billion in over 300 projects in 38 economies in the past 10 years, has recently announced its plan to set up an office in Hong Kong.

investments can strengthen Hong Kong's position as the largest private credit fund hub in Asia and help further attract private credit investment activities in the region[16]. The expanded scope of qualifying investments would also complement Hong Kong's development in areas such as digital assets, and trading of precious metals and commodities through promoting the relevant investment activities in Hong Kong.

28. The proposed enhancements would create new business opportunities for Hong Kong's WAM industry. This in turn would generate demand for other related professional services, including fund administration, legal and accounting services. In particular, with the imposition of the economic substance requirement of not less than an average of two qualified employees and HK$2 million annual operating expenditure in Hong Kong, it would bring measurable benefits to the Hong Kong's economy.

29. It would be difficult to estimate the revenue forgone arising from the enhancement proposals as funds (except limited partnership funds and open-ended fund companies) benefitting from tax exemption under the UFR are currently not subject to any tax reporting obligations. By expanding the range of eligible funds and permissible investments of the tax concession regimes, however, the proposed enhancements would attract more funds and family offices to set up and operate in Hong Kong, thereby stimulating business activities of the relevant industries of professional services which could contribute to tax revenue.

WAY FORWARD

30. As committed in the 2025 Policy Address, we are formulating the legislative proposals concerned and our target is to introduce the amendment bill into the Legislative Council ("LegCo") in the first half of 2026. Subject to the passage of the amendment bill by LegCo, the relevant measures will take effect from the year of assessment 2025/26.

ADVICE SOUGHT

31. Members are invited to comment on the proposal as set out in paragraphs 6 to 26 above.

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[16] Based on Preqin's database, as of June 2025, the asset under management of private credit funds managed in Asia (ex-Hong Kong) amounted to USD58 billion.

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