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Client Alert

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Hong Kong: Proposed tax concession for family-owned investment holding vehicles

In brief

On 9 December 2022, the Hong Kong Government published in the Gazette the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022 (**Bill**). The Bill aims to provide profits tax concession for eligible family-owned investment holding vehicles (**FIHVs**) managed by single family offices (**SFOs**) in Hong Kong with a view to attracting family offices to establish a presence in Hong Kong and to provide tax certainty to FIHVs.

Under the Bill, assessable profits of eligible FIHVs arising from qualifying transactions and incidental transactions (subject to a 5% threshold) will be exempted from tax. The key aspects of the proposed tax concession regime are summarised below.

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Conditions for tax concession

To qualify for the tax concession under the proposed regime, an FIHV must satisfy the following requirements:

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 means a body of persons (corporate or unincorporate) or a legal arrangement and includes a corporation, partnership and trust (including a discretionary trust).
Ownership	At least 95% of the beneficial interest in the FIHV must, at all times during the basis period for the year of assessment, be held (directly or indirectly) by one or more members of a single family. Members of a single family include, whether alive or deceased, (i) the member concerned; (ii) his or her spouse; (iii) their linear ancestors; (iv) siblings of the member concerned, his or her spouse and their linear ancestors; (v) linear descendants of the member concerned and the aforementioned siblings (including children born out of wedlock, adopted children and step children); and (vi) a spouse of the aforementioned siblings and linear descendants.
Central management and control	The central management and control of the FIHV must be exercised in Hong Kong.
Management	The FIHV must be managed in Hong Kong by an eligible SFO of the family to which the FIHV is related. An eligible SFO must: (a) be a private company (incorporated in or outside Hong Kong) exercising central management and control in Hong Kong; (b) have at least 95% of its beneficial interest held (directly or indirectly) by one or more members of the family;

	(c) provide services to specified persons of the family[1] and the fees for the provision of those services are chargeable to tax in Hong Kong; and (d) fulfil the safe harbour rule whereby at least 75% of the eligible SFO's assessable profits should arise from the services provided to specified persons of the family. Not more than 50 FIHVs managed by the same eligible SFO may benefit from the proposed regime. In terms of minimum asset threshold, the aggregate value of specified assets (i.e., assets specified under Schedule 16C to the Inland Revenue Ordinance) (**Specified Assets**) managed by the eligible SFO for an FIHV (or multiple FIHVs) of the relevant family must be at least HK$240 million.
Substantial activities	An FIHV must carry out its investment activities in Hong Kong and fulfil the substantial activities requirement. Subject to an adequacy test, an FIHV must, at the minimum, have: (a) not less than two full-time employees in Hong Kong to carry out the investment activities and who have the necessary qualifications for doing so; and (b) not less than HK$2 million operating expenditure incurred in Hong Kong for carrying out the investment activities. Outsourcing of investment activities to an eligible SFO is permitted provided that the use of outsourcing is not for circumventing the substantial activities requirement.

Qualifying transactions and incidental transactions

Under the proposed regime, an FIHV may enjoy profits tax concession (at the concessionary tax rate of 0%) in respect of:

- transactions in Specified Assets (**Qualifying Transactions**), which must be carried out in Hong Kong by or through an eligible SFO of the relevant family, or arranged in Hong Kong by the eligible SFO; and
- transactions incidental to the carrying out of Qualifying Transactions (**Incidental Transactions**), e.g., receipt of interest or dividend on Specified Assets, subject to a 5% threshold.

Tax concession is provided at both the FIHV level and the FSPE level (if there is an FSPE) to the extent which corresponds to the percentage of beneficial interest of the FIHV in the FSPE, in line with the tax treatment under the unified tax exemption regime for funds (**UFR**). For investment in private companies, the immovable property test, holding period test, control test and short-term asset test applicable to funds under the UFR will similarly apply to FIHVs and FSPEs.

Anti-round tripping and anti-avoidance provisions

The tax concession is subject to anti-round tripping provisions modelled on the provisions applicable to funds under the UFR, which are modified to carve out resident individuals and certain resident non-individual entities (e.g., eligible SFOs and entities that fulfil certain anti-abuse conditions).

The tax concession is also subject to anti-avoidance provisions. 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 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

[1] A specified person, in relation to a family, means (a) an FIHV that is related to the family; (b) a "family-owned special purpose entity" (**FSPE**) which is established solely to hold and administer one or more private companies or Specified Assets, in which an FIHV mentioned in paragraph (a) has a beneficial interest (whether direct or indirect); (c) an interposed FSPE in which an FIHV mentioned in paragraph (a) has an indirect beneficial interest; and (d) a member of the family.

entity), the tax concession will not apply. However, for a transfer of assets or business to the FIHV or FSPE, the tax concession will 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.

Takeaways

At present, the Bill is under scrutiny by the Legislative Council. It is currently envisaged that, once the Bill is enacted, it will have retrospective effect from the year of assessment 2022/23 onwards (i.e., applying to covered transactions from 1 April 2022). An eligible FIHV will need to make an irrevocable election to enjoy the tax concession.

Family offices which currently operate in Hong Kong and persons looking to set up a family office should start considering and assessing how they may benefit from the proposed tax concession regime. As the draft legislation governing the regime is highly complex, interested parties should seek professional advice on the detailed requirements and how the family office and investment holding vehicles should be structured to take advantage of the proposed tax concession.

For further information and to discuss what this alert might mean for you and specific actions to be taken, please reach out to our lawyers set out under "Contact Us" or your usual Baker & McKenzie contact.

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