

HONG KONG TAX

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PROFITS TAX CONCESSION FOR FAMILY INVESTMENT HOLDING VEHICLES IN HONG KONG



As part of the government's initiative to promote family office business in Hong Kong, profits tax exemption will be offered to family-owned investment holding vehicles (FIHVs) that are managed in Hong Kong. Once the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022 is passed, eligible FIHVs will benefit from such tax concession with effect from the year of assessment 2022/23.

We highlight below the key requirements under this tax concession regime and some of our observations. Please do not hesitate to contact your BDO professionals if you would like to discuss further.

References to sections and schedules refer to existing or proposed new sections and schedules to the Inland Revenue Ordinance, unless otherwise stated.

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Eligibility for tax concession

To be eligible, at all times during a year of assessment an FIHV must be an entity:

- with central management and control (CMC) exercised in Hong Kong;
- at least 95% beneficially owned by member(s) of a family;
- not being a business undertaking for general commercial or industrial purposes
- managed by an eligible single-family office (ESF); and
- carrying out its core income generating activities (CIGAs) in Hong Kong meeting at least the minimum asset threshold and substantial activity requirement.

Family-owned special purpose entities (FSPEs) set up and held by an eligible FIHV solely for holding and administering Schedule 16C assets and/or investee private companies will also be eligible for the profits tax concession.

Profits exempt from profits tax

Profits derived by an eligible FIHV:

- from transactions in Schedule 16C assets (ie qualifying transactions), and
- subject to a 5% threshold, profits from transactions incidental to the carrying out of qualifying transactions (ie incidental transactions);

are chargeable at the 0% concessionary profits tax rate.

For an FSPE, profits from transactions in:

- Schedule 16C assets and qualified incidental transactions;
- specified securities of or issued by an investee private company or an interposed FSPE;
- rights, options or interest in those specified securities; and
- certificate of interest or warrants to subscribe for or purchase of those specified securities;

are chargeable at the 0% concessionary profits tax rate.

Currently, dividends and interest income are still regarded as incidental income in the tax administration's viewpoint on the basis that these arise from the holding of equities and fixed income instruments; that holding is not transaction.

Meaning of ESF

An ESF is a private company:

- having CMC exercised in Hong Kong;
- at least 95% beneficially owned by member(s) of the family that holds the FIHV(s);
- providing services to specified persons (ie FIHV(s), FSPE(s), interposed FSPE(s) or member(s) of the family) and the fees for the provision of those services are chargeable to tax; and
- fulfil the safe harbour rule whereby $\geq 75\%$ of its profits should be derived from the services provided to the specified persons of the family.

Schedule 16C assets

This is the same list of assets specified for the purposes of the existing fund tax exemption regime, which includes:

- securities;
- shares, stocks, debentures, loan stocks, funds, bonds or notes of or issued by a private company;
- futures;
- foreign exchange contracts;
- deposits other than those made by way of a money lending business;
- deposits made with a bank(*);
- certificates of deposits(*);
- exchange traded commodities;
- foreign currencies; and
- OTC derivative products(*).

(* as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance

Minimum asset threshold

The assets under management by an ESF must include at least HK\$240 million of Schedule 16C assets. In determining whether this threshold is met, the aggregate amount of net asset value of the specified asset of each relevant FIHV managed by the ESF will be considered.

Substantial activity requirement

An FIHV is required to have:

- at least two full time employees in Hong Kong who carry out the CIGAs for a FIHV having the necessary qualifications; and
- at least HK\$2 million operating expenditure incurred in Hong Kong for carrying out the activities concerned.

Outsourcing of CIGAs to an ESF is permitted. The number of qualified employees and the amount of operating expenditure must be commensurate with the level of the CIGAs carried out in Hong Kong on behalf of the FIHV(s).

Note that only up to 50 FIHVs managed by the same ESF may benefit from profits tax exemption under this concession regime.

Specific anti-avoidance provisions

The tax concession does not apply under certain circumstances, similar to the exceptions under the existing fund exemption regime. The exceptions are rather complex but are centred at investee private companies holding Hong Kong immovable properties and short-term assets.

Compared to the fund regime, the anti-round tripping provisions, which operate to deem tax-exempt profits of the FIHV/FSPE as assessable profits of a resident person if the conditions are met, are modified to exclude:

- resident individuals; and
- certain resident entities as defined (ie ESF and broadly passive holding entities used by family members to hold interest in the FIHV).

The tax concession is also inapplicable if the Commissioner of Inland Revenue is satisfied that:

- the main purpose, or one of the main purposes of an FIHV or an FSPE in entering into an arrangement; or
- 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 for any person.

Compliance

The tax concession applies by election made by an FIHV. The election must be made in writing and is irrevocable.

A responsible person for an FIHV and ESF should keep sufficient records to enable the identity and particulars of the beneficial owners of the FIHV and the ESF to be readily ascertained.

FIHVs and FSPEs may apply for advance rulings, under the existing mechanism, to confirm their eligibility for the tax concession upon enactment of the amendment ordinance.



Our observations

We welcome this encouraging development in Hong Kong's tax law for family offices. We are encouraged that the government has incorporated feedback from various stakeholders, including specific comments from BDO in Hong Kong, made during the consultation process.

There are a number of complexities to navigate in terms of how the tax concession operates and how it interacts with other tax rules or regimes in Hong Kong, including the application of Hong Kong transfer pricing rules to related party transaction between the ESF and affiliates, the recently revised foreign sourced income exemption regime^[1], and hopefully in the near future, greater certainty on determining the taxability of capital gains^[2].

Family offices operating or planning to operate in Hong Kong need to evaluate their structures and operation models if they plan to avail of the tax concession in Hong Kong. BDO tax professionals will be happy to assist.

¹ Our previous newsletters on this can be accessed at:

- [Bill on taxation of specified foreign-sourced income](#)
- [Foreign source income exemption for passive income](#)

² The Financial Services and the Treasury Bureau announced in mid-February that the government will propose an initiative to enhance tax certainty of onshore gains on disposal of equity interests and launch a trade consultation on the initiative in mid-March.

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