

Hong Kong Tax Alert

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Bill granting tax concession to investment vehicles of family offices passes its third reading in the Legislative Council

The Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022 (the Bill), which seeks to introduce a dedicated tax concession regime for Family-owned Investment Holding Vehicles (FIHVs) managed by eligible Single Family Offices (ESFOs) in Hong Kong, is expected to be gazetted on 12 May 2023.

The Bill, as passed, has incorporated several Committee Stage Amendments (CSAs) to the original bill. The CSAs were in response to submissions made by various professional bodies to the Bills Committee aimed at enhancing the original bill to make the proposed tax concession more attractive.

These CSAs include:

- (i) changing the requirement that the FIHVs and the ESFOs must be “centrally managed and controlled in Hong Kong” to “normally managed or controlled in Hong Kong”;*
- (ii) increasing the threshold of the maximum ownership of tax-exempt charities in FIHVs/ESFOs from 5% to 25%, without affecting the eligibility of the FIHVs for the tax concession;*
- (iii) clarifying that non-qualifying investments of FIHVs or Family-owned Special Purpose Entities (FSPEs) in a private company will not taint their tax-exempt profits derived from qualifying transactions; and*
- (iv) empowering the Commissioner of Inland Revenue (CIR) to regard, based on all the circumstances of a case, FIHVs/ESFOs to be 95%, in aggregate, beneficially owned by members of a family in ownership structures involving multiple layers of family trusts (such 95% ownership being a pre-requisite for the tax concession).*

Clients who wish to explore how they can benefit from the new law can contact their tax executives.

Overview of the new law

Under the new law, retrospectively effective from the year of assessment 2022/23, the assessable profits of an FIHV managed by an ESFO in Hong Kong that are derived from qualifying transactions and transactions incidental to said qualifying transactions (subject to a 5% threshold), will be taxed at a 0% concessionary tax rate.

As with the exemption scope of the Unified Fund Exemption regime in Hong Kong, qualifying transactions under the new law refer to transactions in those types of investment assets specified in Schedule 16C to the Inland Revenue Ordinance (IRO).

The tax concession will also apply to FSPEs or interposed FSPEs (IFSPEs) owned by an FIHV in respect of that portion of the assessable profits of the FSPEs/IFSPEs that corresponds to the percentage of beneficial interest held by the FIHV in the FSPEs/IFSPEs.

For details of other qualifying conditions for the tax concession, including; the permitted scope of services of an ESFO; the minimum threshold of HK\$240 million for assets under management of up to 50 FIHVs of a family; and the substantial activities that the FIHVs/ESFOs must perform in Hong Kong, please refer to our alert on the original bill issued on 15 December 2022 (2022 Issue No. 21)¹.

Committee Stage Amendments

From central management and control (CMC) to normally managed or controlled

The CMC condition under the original bill generally required that the top-level control and strategic decisions of an ESFO/FIHV had to be exercised in Hong Kong in order for the ESFO/FIHV to be eligible for the tax concession.

However, the CMC of ESFOs/FIHVs owned by non-Hong Kong resident families may be exercised by senior members of such families based outside Hong Kong. Hence, these ESFOs/FIHVs would have difficulty in satisfying the CMC condition, thereby potentially rendering them ineligible for the tax concession under the original bill.

Under the new law, such ESFOs/FIHVs would generally be able to satisfy the “normally managed or controlled” condition. Whilst high-level strategic investment decisions might be taken outside Hong Kong by senior members of such families, the implementation and execution in Hong Kong of those decisions by the ESFOs/FIHVs would generally be sufficient to render the ESFOs/FIHVs as being “normally managed or controlled” in Hong Kong.

Allowed maximum ownership of charities in ESFOs and/or FIHVs

With a view to accommodating the philanthropic purposes of families, the new law increases from 5% to 25% the maximum ownership in an ESFO and/or an FIHV that can be held by a charitable institution or trust of a public character that is exempt from tax under section 88 of the IRO, subject to the following conditions:

- i. at least 75% of the beneficial interest in the ESFO and/or FIHV must be held by family members; and
- ii. the percentage of beneficial interest that an unrelated person has in the ESFO and/or FIHV, or if there is more than one unrelated person (excluding a charitable institution or trust), the total percentage of such beneficial interests does not exceed 5%.

Clarifying the non-tainting effect of a non-qualifying transaction on other tax-exempt profits

Shares in a private company transacted by an FIHV or an FSPE may turn out to be non-qualifying transactions for the tax concession. This is because the FIHV/FSPE itself, or the private companies it invests in, may not be able to satisfy the relevant three tests, namely (1) the immovable property test; (2) the holding period test; and (3) the control and short-term asset test in order to be eligible for the tax concession.

Under the original bill, where a transaction in a private company becomes a non-qualifying transaction, this could cause otherwise qualifying transactions by the relevant FIHV/FSPE to become taxable, i.e., the otherwise tax-exempt status of the qualifying transactions will be tainted.

Since this was not the intention of the HKSAR Government (the government), CSAs were made to the wording of relevant legislative provisions under the original bill to ensure that no such tainting will occur under the new law.

1. Our previous tax alerts discussing the proposed tax concessions for ESFOs/FIHVs can be downloaded from the below link: https://www.ey.com/en_cn/hong-kong-tax-alerts/proposed-tax-concessions-for-fihvs

Ownership in FIHVs/ESFOs through multiple family trusts or multiple layers of family trusts

Given that it may be hard in practice to ascertain whether the 95%, in aggregate, required beneficial ownership by members of a family in an FIHV/ESFO under complicated trust structures is satisfied, unlike an ownership interest through a corporate chain, the new law contains provisions empowering the CIR to decide the matter by considering all the circumstances of a case.

Under the new law, where it is not possible for the CIR to rely on the specific legislative provisions to deem an FIHV or an ESFO to be 95%, in aggregate, beneficially owned by members of a family, the CIR can nonetheless, based on certain criteria, deem such to be the case.

The criteria are that the CIR is satisfied, after having regard to all the circumstances of the case, including the ownership relationship between the entities in the structure, the value of the trust estate and the terms of the trust documents, that it is highly probable that one or more than one of the family members will have at least 95%, in aggregate, of the beneficial interest in the FIHV/ESFO.

Commentary

We welcome the enactment of the new law which could more flexibly accommodate the different philanthropic causes, modes of operation and holding structures adopted by resident and non-resident families for their ESFOs/FIHVs.

Hence, the new law will enhance the competitiveness of Hong Kong as a preferred location for families to establish new family office businesses or relocate existing family office businesses.

In addition to the existing provisions contained in the Limited Partnership Fund Ordinance and the Securities and Futures (Open-ended Fund Companies) Rules that allow non-Hong Kong domiciled limited partnerships and open-ended fund companies to redomicile to Hong Kong, any relocation of ESFOs/FIHVs will be further facilitated by the proposed amendments to the Companies Ordinance covering the wider re-domiciliation of other types of corporate entities.

In order to further enhance the attractiveness of the tax concession, the government may explore (i) expanding the types of assets that FIHVs can invest in to cover other forms of assets including art pieces and artifacts and other emerging assets such as virtual assets and cryptocurrency; and (ii) adding provisions to the new law to treat interest income derived from holding of debt instruments as being derived from qualifying transactions rather than incidental income, the exemption of the latter being restricted to the current 5% threshold.

Clients who wish to explore how they can benefit from the new law can contact their tax executives.



Hong Kong office

Jasmine Lee, Managing Partner, Hong Kong & Macau
27/F One Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong
Tel: +852 2846 9888 Fax: +852 2868 4432

Non-financial Services				Financial Services	
Wilson Cheng Tax Leader for Hong Kong and Macau +852 2846 9066 wilson.cheng@hk.ey.com				Paul Ho Tax Leader for Hong Kong +852 2849 9564 paul.ho@hk.ey.com	
Business Tax Services / Global Compliance and Reporting				Business Tax Services / Global Compliance and Reporting	
Hong Kong Tax Services				Hong Kong Tax Services	
Wilson Cheng +852 2846 9066 wilson.cheng@hk.ey.com		Tracy Ho +852 2846 9065 tracy.ho@hk.ey.com		Jennifer Kam +852 2846 9755 jennifer.kam@hk.ey.com	
May Leung +852 2629 3089 may.leung@hk.ey.com		Ada Ma +852 2849 9391 ada.ma@hk.ey.com		Ricky Tam +852 2629 3752 ricky.tam@hk.ey.com	
Grace Tang +852 2846 9889 grace.tang@hk.ey.com		Karina Wong +852 2849 9175 karina.wong@hk.ey.com		Leo Wong +852 2849 9165 leo.wong@hk.ey.com	
Joy Chen (Family Office) +852 2846 9688 joy.chen@hk.ey.com					
China Tax Services				Paul Ho +852 2849 9564 paul.ho@hk.ey.com	
Ivan Chan +852 2629 3828 ivan.chan@hk.ey.com		Lorraine Cheung +852 2849 9356 lorraine.cheung@hk.ey.com		Ming Lam +852 2849 9265 ming.lam@hk.ey.com	
Becky Lai +852 2629 3188 becky.lai@hk.ey.com		Carol Liu +852 2629 3788 carol.liu@hk.ey.com		Sunny Liu +852 2846 9883 sunny.liu@hk.ey.com	
Payroll Operate		Helen Mok +852 2849 9279 helen.mok@hk.ey.com			
Vincent Hu +852 3752 4885 vincent-wh.hu@hk.ey.com		Linda Liu +86 21 2228 2801 linda-sy.liu@cn.ey.com		Customer Tax Operations and Reporting Services	
International Tax and Transaction Services				Anish Benara +852 2629 3293 anish.benara@hk.ey.com	
International Tax Services		US Tax Services			
Jo An Yee +852 2846 9710 jo-an.yee@hk.ey.com		Sangeeth Aiyappa +852 2629 3989 sangeeth.aiyappa@hk.ey.com		Camelia Ho +852 2849 9150 camelia.ho@hk.ey.com	
		Kenny Wei +852 2629 3941 kenny.wei@hk.ey.com		Michael Stenske +852 2629 3058 michael.stenske@hk.ey.com	
Transaction Tax Services				International Tax and Transaction Services	
David Chan +852 2629 3228 david.chan@hk.ey.com		Jane Hui +852 2629 3836 jane.hui@hk.ey.com		China Tax Services	
Eric Lam +852 2846 9946 eric-yh.lam@hk.ey.com		Qiannan Lu +852 2675 2922 qiannan.lu@hk.ey.com		Cindy Li +852 2629 3608 cindy.jy.li@hk.ey.com	
People Advisory Services				International Tax Services	
Robin Choi +852 2629 3813 robin.choi@hk.ey.com		Mary Chua +852 2849 9448 mary.chua@hk.ey.com		Sophie Lindsay +852 3189 4589 sophie.lindsay@hk.ey.com	
Christina Li +852 2629 3664 christina.li@hk.ey.com		Jeff Tang +852 2515 4168 jeff.tk.tang@hk.ey.com		Stuart Cioccarelli +852 2675 2896 stuart.cioccarelli@hk.ey.com	
Winnie Walker +852 2629 3693 winnie.walker@hk.ey.com		Paul Wen +852 2629 3876 paul.wen@hk.ey.com		Adam Williams +852 2849 9589 adam-b.williams@hk.ey.com	
Asia-Pacific Tax Centre					
Tax Technology and Transformation Services		International Tax and Transaction Services		Indirect tax	
Agnes Fok +852 2629 3709 agnes.fok@hk.ey.com		US Tax Desk		Shubhendu Misra +852 2232 6578 shubhendu.misra@hk.ey.com	
Robert Hardesty +852 2629 3291 robert.hardesty@hk.ey.com		Jeremy Litton +852 3471 2783 jeremy.litton@hk.ey.com		Andy Winthrop +852 2629 3556 andy.p.winthrop@hk.ey.com	
Albert Lee +852 2629 3318 albert.lee@hk.ey.com		Winona Zhao +852 2515 4148 winona.zhao1@hk.ey.com			
		Operating Model Effectiveness		Tax and Finance Operate	
		Alice Chung +852 3758 5902 alice.chung@hk.ey.com		Tracey Kuuskoski +852 2675 2842 tracey.kuuskoski@hk.ey.com	
		Edvard Rinck +852 9736 3038 edvard.rinck@hk.ey.com			

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