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Hong Kong Tax Alert

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Hong Kong publishes legislative bill[1] to enhance the preferential tax regimes for funds, family offices and carried interest

- *The proposed enhancements will be effective retrospectively starting from the year of assessment 2025/26, with key enhancements outlined below. While the proposed enhancements are generally to be welcomed, many of the provisions of the bill are complicated. Where necessary, clients should contact their tax executive.*
- *As a transitional administrative measure, taxpayers who are eligible for the tax exemption or concession proposed under the bill may submit their tax returns for the year of assessment 2025/26 on that basis.*

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[1] The bill can be accessed via the link below:
[The Government of the Hong Kong Special Administrative Region Gazette]

Under the key proposed enhancements:

Funds

- Funds will include "funds-of-one", provided that the net asset value of the qualifying investments of such a fund is at least HK$240 million and the investors do not have day-to-day control over the management of the assets of such funds. In calculating the HK$240 million threshold, loans from participating persons need not to be deducted from the calculation of the value of the qualifying investments.
- Excepted funds, including "funds-of-one", certain pension, charitable endowment and government-owned funds such as sovereign wealth funds, need not be managed by a specified person for tax exemption purposes.
- Qualifying investments will be expanded to include certain specified assets, e.g., loans and private credit investments, insurance-linked securities, overseas immovable property, digital assets, precious metals and specified commodities (investments in the latter two categories being subject to certain limitations and conditions).

  An exclusion list has also been introduced. Currently, it contains only one item: income that is derived from shares or stocks of a private company and is attributable to property trading or property development in respect of immovable property in Hong Kong. Investing in any item on this list will disqualify it as a qualifying investment.
- All incidental income of a qualifying investment will be tax exempt, i.e. not subject to the existing 5% cap.
- A special purpose entity (SPE) employed by an exempt fund will be fully tax exempt, regardless of the fund's ownership interests in the SPE, provided that no co-investor has day-to-day control over the management of the SPE's property. However, co-investors in the SPE may be subject to the anti-round tripping provisions.
- The scope of an SPE's activities will be expanded to cover the acquisition, holding, administrating and disposal of one or more investee private companies and/or any of its other Schedule 16C assets, and activities incidental to those activities.
- Additional anti-round tripping provisions will be introduced for financial institutions, certain insurance companies, money-lending or intra-group financing businesses in respect of their investments in funds (including their SPEs) which invest in loans and private credit investments, where their beneficial interests in such a fund or SPE are 20% or more; or they have significant influence over the fund or the SPE.
- The existing four tests applicable to investments in securities (both debt and equity) issued by private corporate companies before the tax exemption applies will be modified to apply only to equity investments in private entities, including non-corporate ones.
- Funds will be subject to certain minimal tax reporting and economic substance requirements to be detailed by the Inland Revenue Department, and the timeline for the 2025/26 tax reporting will be extended. Aggregate reporting is used for key financial and economic substance requirements across funds managed by the fund manager.

Family-owned investment holding vehicles (FIHVs) managed by an eligible single family office

- Except for the first two and last items, the above key enhancements or anti-round tripping provisions applicable to funds will also apply to FIHVs (which are already subject to tax reporting and economic substance requirements under the existing legislation).
- Loans from holders of direct beneficial interests in the FIHVs will no longer need to be deducted when calculating the aggregate net asset value of the qualifying investments of the FIHVs in ascertaining the HK$240 million threshold to qualify for the tax exemption.

Carried interest

- Funds will no longer be required to be certified by the Hong Kong Monetary Authority.
- Qualifying payers of eligible carried interest which currently include private equity funds, and their associated partnerships will be expanded to cover all relevant entities within a fund group, regardless of their legal form.
- Eligible carried interest will no longer be subject to any hurdle rate.

- The scope of transactions giving rise to eligible carried interest will be extended from private equity investments to cover profits derived by a fund from any exempt and taxable transactions, including listed securities. Typical performance fees for hedge fund managers should be covered.
- Qualifying persons to receive eligible carried interest will be extended to cover fund managers of excepted funds who are not a specified person.
- Payment of eligible carried interest to qualifying employees of a fund manager group will not need to be paid through a qualifying person such as the fund manager, e.g. it can be paid through a carry vehicle or a personal investment entity of the qualifying employees.

Commentary

The provisions of the Bill essentially reflect what were originally proposed in the earlier consultation paper as modified by adopting many of the suggestions made by stakeholders, including EY during the earlier industry consultation and the ongoing dialogues with the government officials. Clients can refer to our two previous alerts dated 2 December 2024[2] and 24 April 2026[3] for the details.

We particularly welcome the Government timely adoption of EY's latest proposal that, when calculating the HK$240 million threshold for the aggregate net asset value of the qualifying investments of the FIHVs, the liabilities, such as shareholders' loans, should not be deducted from the asset value of the FIHVs.

The adoption of our other proposals such as the eligibility of "funds-of-one" for the tax exemption, expansion of tax-exempt asset classes, expansion of the scope of eligible carried interest and simplification of the fund reporting mechanism, would likely solidify Hong Kong's recently achieved status as the top asset management center worldwide.

Carried interest

We also welcome the relaxation of how eligible carried interest is to be received by qualifying employees. This measure, the legislative provisions for which have incorporated some of the EY suggestions, aligns with common industry practice.

However, while there is relaxation of the payment routes for eligible carried interest, the amount received by a qualifying person or qualifying employee will still need to meet certain conditions.

The conditions are that the amount is received by, or accrued to, a qualifying person or qualifying employee by virtue of a "specified right" held directly or indirectly by the qualifying person or qualifying employee in respect of profits of a fund or a specified entity[4], by way of a profit-related return from the provision of investment management services in Hong Kong by the qualifying person or qualifying employee for the fund or specified entity.

Under the Bill, a qualifying person or a qualifying employee holds a specified right in respect of the profits of a fund or a specified entity if –

(a) A qualifying person or qualifying employee is entitled to receive, whether directly or indirectly, a share of the profits; and

(b) The entitlement –

  a. is determined in accordance with an agreement governing the operation of the fund or entity, or any other agreement in relation to the provision of investment management services for the fund or entity;

  b. is not attributable to the capital contribution of the qualifying person or qualifying employee to the fund or entity; and

  c. is not discretionary but may allow a degree of flexibility concerning the amount, timing, manner of payment or otherwise of the distribution of the share of the profits.

Many of the provisions of the Bill are complex and, where necessary, clients should contact their tax executive.

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[2] The tax alert dated 2 December 2024 can be accessed via the link below:
[Hong Kong Tax Alert 2024 Issue No. 16]

[3] The tax alert dated 24 April 2026 can be accessed via the link below:
[EY Asia-Pacific private equity tax network Tax newsletter (April 2026)]

[4] "Specified entity" means The Innovation and Technology Venture Fund Corporation incorporated under the Companies Ordinance (Cap. 622).

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