Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (fund-consultation@fstb.gov.hk)

20 January 2025

Our Ref.: C/TXG, M140556

Financial Services and the Treasury Bureau
(Financial Services Branch)
24/F, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Attn: Ms. Wing Cheng

Dear Sirs,

Consultation on Preferential Tax Regimes for Privately-offered Funds, Family-owned Investment Holding Vehicles and Carried Interest

The Hong Kong Institute of Certified Public Accountants (the Institute) appreciates the opportunity to provide feedback on the proposals regarding the enhancements of the preferential tax regimes for the asset and wealth management industry. The Institute's Taxation Faculty Executive Committee has reviewed the proposals in the consultation paper (CP) and broadly supports the Hong Kong SAR Government (the Government)'s initiative, in particular, to review the scope of the tax concessions, increase the types of qualifying transactions and improve flexibility for incidental transactions. Our general and more specific comments are set out below for your consideration.

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1. General comments on the proposals

Hong Kong is an international asset and wealth management centre, with assets under management amounting to more than HK$30 trillion. It is also Asia's largest hedge-fund centre and the second-largest centre for private equity management after the Mainland. To attract more funds and family offices with potential to establish a presence in Hong Kong, among other initiatives, it was announced in the 2024-25 Budget that the Government would enhance the preferential tax regimes for related funds, single family offices and carried interest. We are pleased to see that the Government has taken industry feedback into account in the CP to further enhance these preferential tax regimes.

The proposed measures, which aim to expand the scope of tax exemptions and reduce certain thresholds and, in general, increase flexibility and certainty, should be welcomed by the market. Other than our specific comments on certain detailed issues, we support the overall direction of the proposed enhancements and believe that these enhancements will help boost Hong Kong's competitiveness, and strengthen its position as an attractive location for funds and family offices, ultimately stimulating growth within the industry.

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In view of the continuing changes in market developments and practices, we suggest the Government should conduct regular reviews of these regimes to ensure they remain attractive and effective, and that they meet expectations in terms of utilisation. Additional measures should also be considered, where appropriate, to strengthen Hong Kong's competiveness and continue to retain and attract quality investment. For example, to create a more favourable environment for family offices, the Government could consider offering further tax incentives, such as a reduced profits tax rate (e.g., 8.25%) for eligible single family offices.

We look forward to the smooth implementation of the proposed enhancements, as well as the provision of clear guidance from the Inland Revenue Department (IRD) by way of departmental interpretation and practice notes and/or guidance posted on the IRD's website. To maximise participation in these regimes and ensure that the market, including potential investors have a thorough understanding of the benefits and concessions available under the proposed enhancements, the Government should work with different sectors to help promote and advocate these preferential regimes.

We would also suggest exploring non-tax incentives to attract more foreign-based wealthy families to set up family offices in Hong Kong. For example, we understand that offering a faster route for obtaining residency status has been perceived as an attractive incentive for family offices in Singapore. Also, the assets specified under Schedule 16C to the Inland Revenue Ordinance (IRO) for the purposes of the family-owned investment holding vehicle (FIHV) tax concession should be more closely aligned with the list of permissible investment assets under the Capital Investment Entrant Scheme to establish a coherent set of requirements.

2. *Comments on the specific proposals in the CP*

Definition of "fund" (Questions 1 to 4 of the CP)

The CP proposes to expand the scope of funds eligible under the unified fund exemption regime (UFR) to include pension funds and endowment funds. To ensure more comprehensive coverage, we recommend extending the tax exemption under the UFR to include a single investor fund, commonly known as a "fund of one", which is often, in essence, no different from other investment schemes.

Qualifying investments (Question 13 of the CP)

We are pleased to note that the Government has taken up a suggestion in our submission in response to the 2022 Consultation on proposal to provide tax concession for family-owned investment holding vehicles, to include virtual assets in the list of assets specified under Schedule 16C of the IRO. To further enhance the attractiveness of the concession regime applicable to FIHVs, we reiterate our recommendation to extend the tax exemption to other asset classes commonly invested in by family offices, such as artworks and collectibles. This also aligns with the government policy to further develop the market for the arts, cultural and creative industries in Hong Kong. Additionally, while we understand the objective of promoting Hong Kong's Core Climate trading platform, there seems to be no reason to exclude carbon credits traded on other reputable emissions trading

platforms. Provision could at least be made to add other platforms over time, without having to amend the primary legislation.

Income eligible for tax exemption (Questions 14 and 15 of the CP)

The CP proposes to refine the scope of income eligible for tax exemption by (i) including all income derived from qualifying transactions; (ii) removing the 5% threshold requirement for incidental transactions; and (iii) introducing an exclusion list whereby income specified in the list will not qualify for the tax exemption, e.g., income derived from private companies that engage in property trading or property development of immovable properties in Hong Kong.

To provide greater clarity to taxpayers, we suggest providing additional guidance regarding the types of income eligible for tax concessions, particularly for the assets newly added to Schedule 16C. For example, it would be helpful if it could be made clear whether staking income from virtual assets is eligible for the tax concessions.

Definition of an special purpose entity (SPE) (Questions 16 and 17 of the CP)

The CP proposes to expand 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 these activities. We welcome the proposed expansion and it will be helpful if it could be clarified whether the expanded scope of permissible activities would also apply to Schedule 16C assets, not only to investee private companies and other SPEs.

We appreciate the introduction of the proposed de minimis rule whereby an SPE will be fully exempted from tax in relation to the profits earned from qualifying transactions, provided that the fund has at least 95% of the beneficial interest (whether direct or indirect) in the SPE concerned. However, we are concerned that the 95% threshold could affect the attractiveness of the enhancement, as it may not benefit some common investment arrangements in the market. For example, it is unlikely to facilitate most of the co-investment scenarios, as co-investors typically hold more than 5% of the interests in the SPE. We recommend that the proposed threshold be reviewed and potentially adjusted downwards. Anti-abuse provisions could be introduced to address any potential concerns about misuse.

Tests applicable to transactions in private companies (Question 18 of the CP)

The CP proposes to remove the control test and short-term asset test, and apply only the "immovable property" and "holding period" tests, in assessing whether tax exemption is available for profits from transactions in a private company under both the UFR and the FIHV tax concession regime. Separately, subject to views on the proposed inclusion of interests in non-corporate private entities as permissible assets, the CP proposes that the same sets of tests will equally apply to the non-corporate private entities.

While we welcome the simplification of tests under the preferential tax regimes, we are concerned that retaining the holding period test while removing the control test and short-term asset test would, in practice, narrow the scope of the tax concessions rather than expand them. Currently, even if the holding period test is not met, a fund/FIHV can still qualify for tax exemption if it does not control the private company. However, without the control test, it seems that, if the fund/FIHV holds a private company for less than two years (failing the holding period test), the transaction may not qualify for the tax exemption, even if the private company is not controlled by the fund/FIHV.

Since the proposed amendments may affect the intended benefits and overall attractiveness of the preferential tax regimes, one option would be to remove the holding period test, along with the control test and short-term asset test, thus retaining only the immovable property test. Alternatively, no changes should be made to the existing tests applicable to transactions in private companies.

Tax reporting and substantial activities requirement (Questions 21 & 22 of the CP)

To ensure that Hong Kong complies with international tax standards, the CP proposes to implement a tax reporting mechanism for funds and SPEs benefiting from the UFR, under which certain accounting data of the funds and SPE concerned, as well as information showing that the tax exemption conditions and "substantial activities" requirements are satisfied, will be required.

The CP proposes introducing a "substantial activities" requirement for funds, mandating at least two qualified employees and an annual operating expenditure of at least HK$2 million, and subject to an "adequacy test". Outsourcing of the investment services to third parties or associates would be allowed provided that the investment services were carried out by an outsourced entity in Hong Kong and the fund exercised adequate monitoring and control on the carrying out of the relevant activities by the outsourced entity.

Since the introduction of the Hong Kong profits tax exemption regime for investment funds over a decade ago, it has all along been operated on a self-assessment basis, without any substantial activities requirement. In particular, the UFR has always been a self-assessment system, and pre-approval from the IRD is not required to enjoy the tax concession. Overseas-domiciled funds that meet the criteria for the UFR are also not required to submit any annual profits tax returns to the IRD.

We understand the reason for these reporting requirement, given the Organisation for Economic Co-operation and Development's increasing focus on potentially harmful preferential tax regimes, along with an emphasis on substantial activities requirements and ongoing monitoring by the relevant tax authorities. Nevertheless, the proposed reporting mechanism should be handled with care, given its significant contrast to the existing self-administered scheme. We hope that the IRD will adopt a pragmatic approach when implementing the new tax reporting mechanism and the substantial activities requirement.

The introduction of the new tax reporting requirement may be perceived as an added administrative burden for investment funds managed in Hong Kong. While tax reporting requirements are not entirely new in the region, we understand that

Singapore's Section 13D (Offshore Fund Tax Incentive Scheme) has been operating on a self-assessment basis. In this context, we agree that tax reporting, if necessary, should be as simple as possible and we that only essential information will need to be reported. In addition, we suggest providing more guidance on how funds, particularly offshore funds, can comply with the tax filing requirement.

Meanwhile, instead of requiring each fund and individual SPE to fulfil the substantial activities requirement, we propose applying the requirement on a consolidated basis for the fund and all SPEs held by the fund, directly or indirectly, as a whole. This approach will allow more flexibility for taxpayers.

Qualifying payers of eligible carried interest (Questions 26 & 27 of the CP)

The CP seeks to expand the coverage of "associate" and introduce the concept of "closely related entity of certified investment fund" under the definition of "qualifying payer". With the proposed definition of "closely related entity", we would suggest 50% of beneficial interest, for example, voting rights or profit sharing ratio, as an objective threshold to determine "control" from a practical perspective.

Payment of eligible carried interest to qualifying employees (Question 31 of the CP)

We support the proposed removal of the "paid through the qualifying person" requirement as it could accommodate most of the possible distribution arrangements for carried interest.

Under Schedule 16D to the IRO, a certain percentage of eligible carried interest received by or accrued to a qualifying employee on or after 1 April 2020, for any year of assessment commencing on or after that date, is excluded from the calculation of salaries tax. At present, this percentage is 100%. To further enhance the competitiveness of the preferential tax regimes, consideration could be given to the possibility of expanding the definition of "qualifying employee", under section 8 of Schedule 16D, to cover functional heads (director, chief executive officer, financial controller, head of human resources, etc.) This would enable senior management personnel who might have received carried interest without providing any investment management services to also take advantage of the tax concession, and thus attract more funds to make use of the preferential tax regimes.

To conclude, we broadly welcome the proposed enhancements to the UFR, the FIHV tax concession regime and the carried interest tax concession regime. They not only address some long-standing issues facing the industry, but also improve the attractiveness of the existing regimes significantly. We expect that the proposed enhancements will further solidify Hong Kong's status as an international asset and wealth management hub by attracting more funds and family offices to establish and operate here. To ensure effective implementation, we hope that the Government provide sufficient clarification and guidance before proceeding with the changes and will also consider the other issues raised in this submission.

Should you have any questions on this submission, please feel free to contact me at peter@hkicpa.org.hk or on 2287 7084.

Yours faithfully,

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Advocacy & Practice Development

PMT/SC/pk