DISCUSSIONS ON

OPPORTUNITIES AND DEVELOPMENTS OF FAMILY OFFICE IN HONG KONG

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Can Hong Kong continue to be a leading hub for family offices?

The Chief Executive, in his Policy Address last October, has set a target of attracting at least 200 family offices to establish or expand in Hong Kong by the end of 2025.

Hong Kong, with its vibrant financial ecosystem, sophisticated financial infrastructure and the best professional services providers, is naturally the preferred choice of location for global family offices. Let alone the connectivity with the Mainland which has made Hong Kong the only place in the world where Mainland and global investment opportunities converge.

What Hong Kong is doing

Due to its status as a prominent financial center, Hong Kong has long been a favored destination for family offices. Its deep liquidity, diversified asset classes, and investible products have attracted **18 of the world's largest 500 family entries** to the territory, the highest number in Asia-Pacific. Overall, there are about **400 family offices** operating in Hong Kong.

Despite its traditional appeal as a hub for family offices, Hong Kong has faced a mix of challenges in recent years, including political turmoil and the pandemic management, leading some family businesses relocating to Singapore. However, recognizing the crucial role played by family offices as key investors, the Hong Kong Government is stepping up its efforts to attract more of them in 2023.

On the Government's side, new legislation has been recently passed to enhance the competitiveness of its tax system for family offices. The Government has also set up a dedicated team in "Invest Hong Kong" named "FamilyOfficeHK". With the support of the financial regulators - the Securities & Futures Commission (SFC), the Hong Kong Monetary Authority (HKMA), Hong Kong is demonstrating the accelerated development in this particular area.

Indeed, this Network of Family Office brings together the relevant professional services providers, including private bankers, trustees, lawyers, accountants, wealth management professionals, etc, where they can meet each other and make mutual business referrals.

Source: https://www.news.gov.hk/eng/2023/06/20230612/20230612_143740_322.html

Hong Kong tax concessions to welcome family offices set-up

As part of government policy to further promote the Hong Kong ecosystem for operating family offices with reference to investment holding, investment activities and other related activities in running a family office, ***the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Ordinance 2023 was gazetted on 19 May 2023*** (the Family Office Tax Concessions Ordinance or the "Ordinance" hereafter), and will apply with immediate effect to years of assessment commencing on or after 1 April 2022.

The Ordinance provides a package of tax incentives intended to ***attract and encourage high net worth private families to set up family office in Hong Kong and operate family-owned investment holding vehicles (FIHVs) from Hong Kong***. This is a much-anticipated development welcomed by the market to bolster opportunities in Hong Kong as a premier family office hub, enhancing the city's well ***established position as an international asset management and wealth management centre***.

The Ordinance amends the Inland Revenue Ordinance (Cap. 112) (IRO) to provide profits tax concessions for eligible FIHVs on assessable profits earned from qualifying transactions and incidental transactions, being a concessionary tax rate of 0%.

Hong Kong tax concessions to welcome family offices set-up

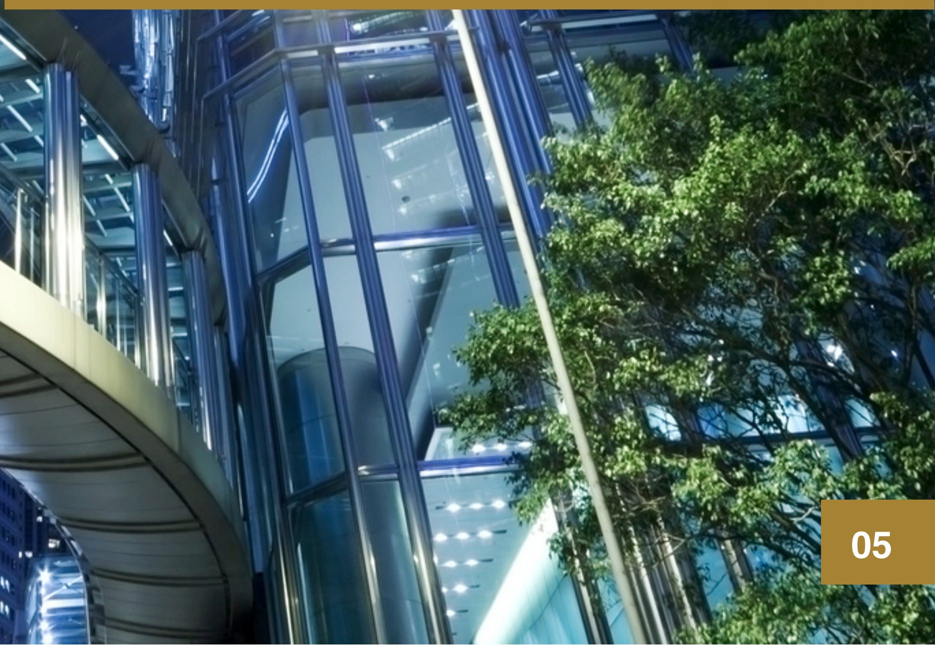
An FIHV may be established in or outside Hong Kong, while it cannot be a business undertaking for general commercial or industrial purposes. Subject to relevant conditions, ***the tax concessions may extend to such special purpose entity or interposed special purpose entity (FSPE) established for investments of the family and the FIHV. The FIHV is required to be managed by an eligible single family office (SFO) in Hong Kong and meet minimum asset threshold of HK$240 million (or equivalent in foreign currency) in qualifying assets***.

There are also substantial activities requirements of having:

- average number of qualified employees during the relevant basis period as considered adequate in the opinion of the Commissioner of Inland Revenue and in any event not less than two;
- total amount of operating expenditure incurred in Hong Kong for carrying out investment activities as considered adequate in the opinion of the Commissioner of Inland Revenue and in any event not less than HK$2 million.

To meet such requirements, qualified employees should be full-time employees in Hong Kong carrying out investment activities in Hong Kong, with the qualifications necessary for doing so.The application of the profits tax concessions is not subject to prior approval by any regulatory body. However, an FIHV can elect for profits tax concession through an election in writing and, to obtain tax certainty, application can be made to the Commissioner of Inland Revenue for advance ruling on the eligibility for profits tax concessions.

What counts as family or family-owned investment vehicles (FIHVs)?



What counts as family or family-owned investment vehicles?

Under the Ordinance, the term "family" is defined rather broadly to refer to ***a natural person and all persons related to him or her ("such person"), being his or her spouse, or his or her lineal descendant, the spouse of such lineal descendant, lineal ancestor of such person or of the spouse of such person, a sibling of any of the aforesaid persons, as well as lineal descendant of any such sibling, and a spouse of such sibling or lineal descendant.*** "Lineal descendant" includes a child of such person or of his or her spouse or former spouse, whether or not the child was born in wedlock, and also includes adopted child or stepchild. "Siblings" include full or half-blood siblings, adopted siblings, step-siblings, and a natural child of an adoptive parent of such person.

In relation to the particular family, ***one or more member(s) of the family must have at least 95%, in aggregate, of the beneficial interest in the SFO and the related FIHV respectively***, in the relevant year of assessment. Beneficial interest, direct or indirect, may be through a corporation, partnership, trust, trust estate or other structure, subject to the detailed provisions of the Ordinance in determining the extent of beneficial interest of family members. The Commissioner of Inland Revenue has the power to regard an FIHV or SFO to be beneficially owned in aggregate by at least 95% by members of a family through ownership structures that may involve multiple layers of family trusts, as may be considered based on all circumstances of the case.

Network of Family Office Service Providers launched to promote Hong Kong as preferred destination for global family offices on June 12, 2023

ELIGIBLE SFO AND QUALIFYING TRANSACTIONS

Eligible SFO and qualifying transactions

An eligible SFO may ***manage no more than 50 eligible FIHVs that elect in writing for tax concessions under the Ordinance*** in relation to the management of investments by the SFO.

"Eligible SFO" refers to a private company that is normally managed or controlled in Hong Kong, and the company provides services to specified persons of a family. Conversely, there is a safe harbour condition that the aggregate amount of management profits of the SFO derived from services to specified persons, FIHV or FSPE of the family should be more than or equal to 75% of the profits of the SFO from all sources in Hong Kong for the relevant year of assessment. Fees for the provisions of such services by the SFO are chargeable to profits tax.

The SFO may conduct investment activities in relation to an FIHV (and/or underlying FSPE) which include conducting research and advising on potential investments, acquiring, holding, managing or disposing of investments, and establishing or administering FSPE holdings and administering underlying investments of the FIHV. It is ***one of the conditions for the profits tax concession that the qualifying transactions of an FIHV are carried out in Hong Kong by the SFO of the family that manages the FIHV, or are arranged in Hong Kong by such office***.

Qualifying transactions include transactions in Schedule 16C assets (under the IRO), covering securities, futures contracts, foreign exchange contracts and foreign currencies, deposits, exchange-traded commodities and OTC derivative products, and also investments in underlying investee private companies (in Hong Kong or elsewhere). However, there are certain exceptions on investments in private companies directly or indirectly holding immovable property in Hong Kong that may disapply the tax concession on the assessable profits from such transactions.

Eligible SFO and qualifying transactions

Non-qualifying incidental transactions may be allowed for profits tax concessions up to the threshold of 5% of the total trading receipts from qualifying transactions and incidental transactions in the basis period.

Charitable entity conditions

It is especially noteworthy that the Ordinance provides for the said beneficial interest requirement to be ***considered as met if one or more member(s) of the family has at least 75% in aggregate of the beneficial interest and, at the same time, one or more than one charitable entity(s) has direct or indirect beneficial interest, with no unrelated person having a beneficial interest (direct or indirect), or the total percentage of beneficial interest of an unrelated person (in aggregate if more than one) does not exceed 5%***. For determining interest of an unrelated person, beneficial interest through a charitable entity is to be disregarded and there should be no double counting.

Charitable entity conditions

"Charitable entity" refers to a charitable institution or trust of a public character exempt from tax under section 88 of the IRO. As such, the Ordinance allows tax-exempt charities in Hong Kong to have beneficial ownership of up to 25% in the investments of the family office.

The Ordinance therefore ***recognises or anticipates that a family may establish charitable entity(s) in Hong Kong or provides a legacy gift to charitable entity(s) which may hold beneficial interest in the investments of the family***. Having said that, there is no requirement for the charitable entity to be one founded or established by the family, and is open generally for any charitable entity which may have beneficial interest or co-invest up to 25% beneficial interest in the family investments within the permitted framework of the family office tax concessions.

Anti-round tripping and anti-avoidance provisions

While the Ordinance intends to offer tax incentives for family office investments, there are ***anti-round tripping provisions which may apply where the beneficial ownership of a Hong Kong resident person in relation to a relevant FIHV or FSPE is, either alone or jointly with any of the person’s associate, no less than 30% in the FIHV or FSPE*** (as determined according to the detailed provisions of the Ordinance), and the assessable profits of the FIHV (or FSPE) may be regarded as assessable profits of the resident person (and thereby chargeable to tax on such resident person). The circumstances in which a person may be an "associate" as set out in the Ordinance and in this connection also the definitions of "related person", "associated corporation" or "associated partnership" are rather extensive and may apply in different scenarios or structures.

There are ***also anti-avoidance provisions on any arrangement of an FIHV transferring any assets or businesses directly or indirectly by a person carrying on business in Hong Kong to the FIHV, if the income of the transferor in relation to the transferred assets or business would have been subject to tax in Hong Kong*** but for the transfer, and the Commissioner of Inland Revenue considers that the main purpose, or one of the main purposes, of the transfer is to obtain a tax benefit, or where the transfer is not carried out on an arm's length basis.

Hong Kong Financial Secretary Paul Chan Mo-po speaks at a press conference on May 23, 2023

SFC clarified licensing requirements for single-family offices

On March 21, 2023, the Securities and Futures Commission (SFC) of Hong Kong issued a few quick reference guides to address frequently asked questions about licensing requirements, with one specifically catering to family offices. Under the **new guidelines**, single-family offices will no longer require a license, as long as they do not engage in a regulated business activity in Hong Kong. Indeed, the policy is expected to boost the development of family offices in Hong Kong, particularly those catering to high-net-worth individuals. ***By reducing the regulatory burden, the exemption will make it easier for single-family offices to operate in Hong Kong***.

What are the conditions for licensing exemption?

A single-family office (SFO) can be exempted from licensing under the Securities and Futures Ordinance if it meets the below requirements:

- it does not carry on business in Hong Kong; and
- does not perform any of the regulated activities.

However, multi-family offices, which typically operate as commercial entities, are more likely to require a license.

This decision is part of a broader strategy by the SFC to **attract more private wealth management firms to Hong Kong** and establish the city as a premier destination for managing private wealth. In line with this, on March 24, 2023, the Hong Kong government issued a **Policy Statement on Developing Family Office Businesses in Hong Kong** to foster a competitive environment for global family offices and asset owners, outlining a series of measures to develop family office businesses in the city.

Moreover, the SFC hopes that the move will attract more private wealth management firms to the city, which has witnessed a surge in demand for family office services in recent years. This exemption is likely to encourage more firms to establish themselves in Hong Kong, tapping into the potential opportunities offered by its thriving wealth management industry.

When does a family office need a license?

Under the Securities and Futures Ordinance, a family office in Hong Kong requires a license if it engages in regulated activities and carries out business within the city. These regulated activities are divided into ten different categories:

- Dealing in securities
- Dealing in futures contracts
- Leveraged foreign exchange trading
- Advising on securities
- Advising on futures contracts
- Advising on corporate finance
- Providing automated trading services
- Securities margin financing
- Asset management
- Providing credit rating services

The specific definition of individual activities and their applications can be found here.

Additionally, family offices that carry on businesses in Hong Kong are subject to mandatory licensing. The specifics of it will need to be determined by reference to the facts of each case, including whether:

- the person is performing an occupation or a duty that requires attention; the activity involves continuity;
- the activity is capable of making a profit; and
- the activity was carried out for the purpose of making a profit.

However, there are two carve-outs that could exempt a family office from licensing for asset management under the SFO. The first carve-out applies to services provided exclusively to the office's group company regarding the group's assets. The second carve-out pertains to activities incidental to the trust service of a registered entity under the Trust Ordinance.

Market outlook for family offices ecosystem

Besides the family office tax concessions now in place, the market can look forward to other measures, including a proposed reintroduction and expansion of the Capital Investment Entrant Scheme (CIES), efforts to develop Hong Kong into a philanthropic centre for global family offices and philanthropists, and proposed streamlining of applications for recognition of tax-exempt status of charitable entities.

As the Financial Secretary, Mr Paul Chan, said: "The Policy Statement demonstrates our determination to develop Hong Kong into a leading global family office hub. Developing family office business will be conducive to pool capital from around the world in Hong Kong, bolster our financial market, as well as asset and wealth management industry. It will also promote the sustainable development of Hong Kong's financial and professional services, innovation and technology, green, arts and culture and philanthropy, creating strong impetus for Hong Kong's growth."

Please get in touch for further details on the tax concessions, the relevant eligibility, qualifying conditions and other issues to consider in operating a family office and investment holding structures.

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