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In this article, Yip and Chik explain Hong Kong's new family office regime and compare it with the Singaporean regime, pointing out the benefits specific to Hong Kong.

The growth in family offices (FOs) among Asia's wealthy has been phenomenal in recent years. According to a survey,[1] 80 percent of the FOs in the Asia-Pacific region were established after 2000, of which two-thirds were set up in the last 12 years. Many jurisdictions hope to attract FOs to their territory, betting on the economic benefits that FOs could help create. With more FOs, it is expected that occupancy rates of grade A office space, employment, inflows of funds into local capital markets, demand for professional services, and other related goods and services will go up, giving the local economy a helpful boost. In May, Hong Kong enacted a new concessionary tax regime for family-owned investment holding vehicles (FIHVs) managed by a single FO. The tax concession applies retrospectively from the 2022-2023 assessment year (from April 1, 2022).

The key question for a jurisdiction trying to attract more FOs is how can the jurisdiction come up with a regulatory regime that would entice wealthy families to set up shop? An attractive regime would offer most, if not all, of five competitive advantages:

- favorable tax regime;
- low threshold for qualification;
- minimal government involvement with the initial approval and annual maintenance procedures;
- conducive immigration policy; and
- a free economy with world-class capital markets.

This article discusses whether, and to what extent, Hong Kong's newly created FO regime fits the bill on these five competitive advantages.

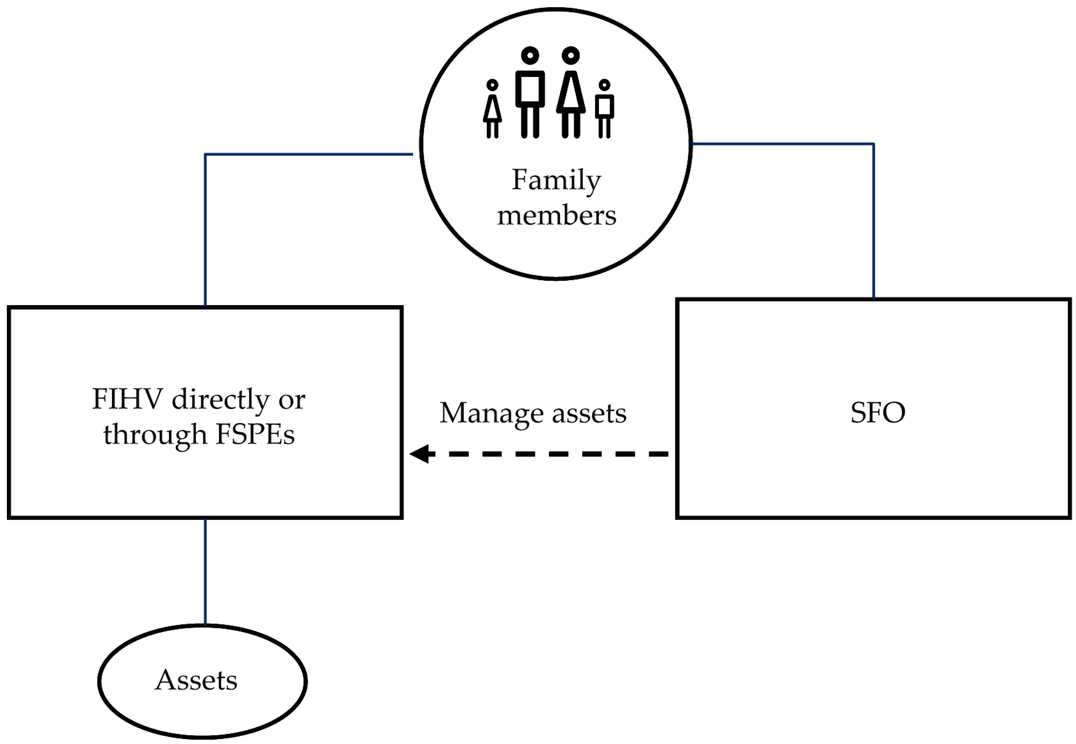
What Is an FO?

An FO is a company that provides prescribed services to prescribed family members. The services generally encompass:

- asset management;
- professional assistance like procuring professional services for family governance, succession, tax, and legal advice;
- education support like facilitating applications to, and enrollment in, boarding schools and universities for family members;
- immigration assistance such as facilitating immigration applications for family members;

[1] Campden Wealth, "The Asia-Pacific Family Office Report 2022" (2022).

Figure. A Typical Single Family Office Structure Under the Hong Kong FO Regime



- lifestyle and concierge services like facilitating art collecting or making travel arrangements for family members; and
- assisting with philanthropic activity.

It is not uncommon for an FO's asset management to be the most crucial function of the office. An FO may serve a single family or multiple unrelated families. Hong Kong's FO tax concession covers only investment-holding vehicles managed by FOs that serve a single family via a single-family office (SFO).

A typical SFO structure (see figure) comprises one or more FIHVs that hold the family's wealth, often consisting of secondary market stocks and securities, assets held through special purpose vehicles (family special purpose entities). Also, there is often a separate entity that serves as the SFO that manages the FIHV's assets.

Advantages of Hong Kong as an FO Hub

Tax Regime

Hong Kong enjoys the reputation as one of the most tax-friendly jurisdictions in Asia. For example, its standard individual tax rate is 15 percent and only applicable to salaries, business profits, and property rental income. In other words, dividends, most interest income, and capital gains received by individuals are tax-free. Why would Hong Kong need to separately institute an FO concessionary tax regime?

If financial assets are held in an entity (not by an individual) and the entity acquires and disposes of financial assets, it is not clear if it would qualify for tax-free treatment on capital gains that would be tax-free if received by an individual. In general, a corporation or partnership is considered to have a profit-seeking motive and to carry out profit-making (business) activities. Consider the following example: X, a wealthy nonresident of Hong Kong, established a British Virgin Islands company (BVICo) which opened an account with a private bank in Hong Kong. BVICo trades stocks and securities (including those listed in Hong Kong) and holds the stocks and securities for capital gain. It is possible that BVICo would be considered to carry on a trade or business in Hong Kong (through the private bank in Hong Kong) and derive Hong Kong-sourced profits. Even though some of the stocks and securities may have been held long-term (for example, more than three years), sales may still be treated as trading revenue within BVICo's profit-making business (typically these would be tax-free if received by an individual).

Because this structure is not considered foreign investor-friendly or conducive to enhancing Hong Kong's international financial center position, in 2006 the government introduced the Offshore Fund Exemption Regime (OFER) with amendments made in 2015, which exempts from Hong Kong taxation nonresident investment funds like private equity and venture capital funds, and even companies like BVICo (in the above example), provided specific conditions are met. This is welcome news to many nonresident individuals like X in our example above. However, investors like X must continue to not be a Hong Kong resident to qualify for the benefit. OFER is meant to benefit nonresidents only, and there is a set of anti-round-tripping rules that would preclude the application of the tax exemption to the portion of BVICo's income attributable to a more-than-30-percent Hong Kong resident owner.

What would happen if X decided to move to Hong Kong? The OFER exemption would be forfeited. This would become an impediment if X were considering a move there. Hong Kong was therefore faced with a choice: Continue with OFER and let people like X (and the potential economic benefits that X may bring to Hong Kong) move to another jurisdiction; or make an exception to OFER to attract individuals like X to move to Hong Kong. The new FO regime is the latter. If the FO conditions are satisfied, the FIHV's investment income (in particular capital gains — but not capital gains from disposal of Hong Kong real estate, which would remain taxable), even if it is derived from Hong Kong, would not be taxable in Hong Kong regardless of whether the beneficial owners are Hong Kong residents.

This is relevant to nonresidents who are planning to move to Hong Kong as well as to families already resident who have been dogged by OFER's anti-round-tripping rules.

Qualification

Under the new FO regime, an FIHV or family special purpose entity can enjoy a 0 percent tax rate for profits derived from qualifying transactions in specified assets (for example, shares, stocks, debentures, futures contracts, foreign exchange contracts, over-the-counter derivative products, etc.) and transactions incidental to them[2] (subject to a 5 percent threshold). To be eligible for the tax-free treatment, an FO structure would need to meet certain requirements regarding the FIHV and SFO. The key requirements are highlighted below:

> **Legal form:** Under the FO regime, an eligible FIHV could be a body of persons or a legal arrangement but not limited to a corporation, partnership, or trust. FO structures can include entities with different legal forms, allowing more FIHVs to apply for the tax concession.
>
> **Broad definition of family members:** Both the eligible FIHV and eligible SFO should be at least 95 percent held (directly or indirectly) by members of a single family. The definition of a family member[3] is broad and accommodating. It can even cover a divorced spouse and the spouse's connected persons for two years from the year of divorce[4] so that the FIHV/SFO would not be immediately disqualified (assuming the spouse has a significant interest in the FIHV/SFO) when the divorce is finalized.

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[2]Typical incidental transactions include custody of securities, and receipt of interest or dividend on securities acquired through the qualifying transactions.

[3]It includes spouse, parent, grandparent, child (including adopted and stepchild), grandchild, sibling (including spouse's sibling) and their spouse, child, etc.

[4]If a spouse ceases to be a spouse during the year of assessment that begins on or after April 1, 2022, the spouse and those persons who are connected to the spouse and considered as members of the family before the cessation would still be regarded as members of the relevant family for the year of assessment and the following year of assessment (that is, a total of two years).

Charities as beneficiaries: The FO regime includes some specific features to cater to families' philanthropic activities. An approved tax-exempt charitable entity under the Hong Kong Inland Revenue Ordinance is allowed to hold up to 25 percent of beneficial interest (direct or indirect) in an FIHV and still be eligible for the tax concession.

Service scope of SFOs: An eligible FIHV must be managed by an eligible SFO. An SFO may carry out different types of services for the family as described above, and often such services may not be provided to only the FIHV. For example, SFO may provide lifestyle and concierge services to certain members of the family individually and provide asset management services to an FIHV. Hong Kong's FO regime, however, is flexible enough that as long as a family member or FIHV is considered a recipient of SFO's services, the services performed by SFO will be qualifying, provided that service income is chargeable to profits tax. The only situation in which an SFO could be treated as performing nonqualifying services would be when it receives more than 25 percent of its assessable profits (fees received by SFO for its services) from non-family members or non-FIHVs.

Normal management or control: To enjoy the tax concession, the FIHV and SFO are required to be "normally managed or controlled" in Hong Kong. The requirement is fulfilled if either the management of daily operations or the highest level of control of the FIHV and SFO are in Hong Kong. In contrast, other concessionary regimes, for example, corporate treasury center and shipping and aircraft leasing, a higher requirement of "central management and control" is generally imposed. The use of the "normally" language (which is likely a first under Hong Kong law) reflects the extent to which the Hong Kong government intends to make the regime as friendly as possible. Consider the situation in which a family wishes to have its FIHVs managed by multiple SFOs around the world (for example, Hong Kong, Singapore, and New York). If the FIHV were required to be centrally managed and controlled in Hong Kong by the Hong Kong SFO, it would prohibit the family from having other significant SFOs in other jurisdictions. Also, the fact that the Hong Kong SFO can be normally managed and controlled in Hong Kong may mean that its employees would not necessarily have to be physically in Hong Kong most of the time — it would be convenient and practical for frequent-traveling executives.

Minimum asset threshold: The FO regime in Hong Kong has a relatively low minimum threshold. Assets managed by the SFO for the FIHV or multiple FIHVs must be at least HKD 240 million (about $31 million) in aggregate. There is no local investment requirement (no requirement that any of the assets to be invested in Hong Kong stocks and securities). Singapore, on the other hand, requires a fund size of SGD 50 million (about $37.5 million) and local investments equal to at least 10 percent of the asset under management or SGD 10 million (about $7.5 million), whichever is lower.[5] Hong Kong's FO regime, from this standpoint, is less demanding and more flexible.

Substantial activities requirement: The local substance requirements in Hong Kong are also relatively simple and straightforward: two full-time employees (Hong Kong residents or nonresidents who are in Hong Kong on work visa) and local operating expenditure of HKD 2 million (about $250,000). There is no specific requirement on the qualification of the employees and it is generally expected that the bar to qualifying as an eligible employee for an SFO would be low. The Singapore FO regime appears to have a more stringent requirement on who

[5] Monetary Authority of Singapore (MAS), "Fund Tax Incentive Schemes for Family Offices" (July 5, 2023).

qualifies as an eligible investment professional (for example, a trader, research analyst, portfolio manager, etc., with significant experience). For a certain type of FO, Singapore requires three investment professionals, at least one of whom is a non-family member and a Singapore tax resident. As for local business spending, Singapore imposed a tiered spending requirement ranging from SGD 200,000 (about $150,000) to SGD 1 million (about $750,000) based on the fund size.

No license requirement: In general, an SFO is not required to apply for a license under the Securities and Futures Ordinance if it does not carry on the business of a regulated activity, for example, managing third parties' money.

Government Approvals

Unlike Singapore,[6] the Hong Kong government does not require qualifying FIHVs and SFOs to obtain preapprovals to become eligible for the FO regime. A qualifying FIHV only needs to file a tax form to inform the Inland Revenue Department (IRD) that it elects to be eligible for the FO regime. This filing presupposes that the FO is satisfied that it has met all the requirements for the regime. It is expected that the IRD may, at its discretion, conduct audits of FIHVs or the SFO to determine if the requirements have been met. It is also expected that the audits would generally be conducted in a way so as to avoid undercutting the friendliness the government intended as part of the FO regime. A more discerning FO may consider applying for an advanced ruling from the IRD over its eligibility to minimize the likelihood of an audit and provide the FO with an ease of disposal if an audit arises.

Talent and Immigration Policy

Hong Kong's immigration system has a straightforward path to permanent residence — seven years of residence in Hong Kong. Compared with Singapore,[7] Hong Kong's path would seem to be more certain and not necessarily subject to policy considerations that could vary depending on factors such as backlogs of applicants, pressure on social infrastructure, etc.

The Hong Kong government is actively pursuing talented people and people with capital. It recently expanded its immigration programs[8] to attract qualified individuals, who may qualify under different programs with different requirements. According to the Hong Kong government,[9] its talent-related initiatives have received a positive response, with about 61,000 out of 100,000 applications to various talent admission schemes receiving approval as of the end of June. It is not surprising that the FO regime, which requires at least two full-time employees to work for an SFO, does not mandate that they be Hong Kong permanent residents. In other words, talents from outside Hong Kong would be welcome to fill these SFO vacancies under one of these immigration programs.

Hong Kong has also instituted a number of programs[10] to nurture and develop talent for the private wealth industry that would further

[6]Application for the FO tax incentive must be submitted to the MAS together with required information, for example, the shareholding structure of the family group, how the FO is related to the investment fund vehicle and the beneficiaries, investment strategy/objective, etc. The MAS will release the outcome of the tax incentive application in about three to six months.

[7]In considering the application for permanent residence, Singapore takes into account factors such as the individual's family ties to Singaporeans, economic contributions, qualifications, age, family profile, and length of residency, to assess the applicant's ability to contribute to Singapore and integrate into the society, as well as his or her commitment to sinking roots in Singapore.

[8]The Hong Kong government introduced a new Capital Investment Entrant Scheme in which applicants invest a certain amount in the local asset market (except property). Upon approval, they may reside and pursue development in Hong Kong. Other initiatives include launching the Top Talent Pass Scheme, suspending the annual quota under the quality migrant admission scheme, relaxing the immigration arrangements for non-local graduates, and introducing a refund mechanism for the extra stamp duty paid by eligible incoming talents in purchasing residential property in Hong Kong.

[9]News.Gov.HK, "61k Talent Applications Approved" (July 14, 2023).

[10]The Hong Kong government introduced the Pilot Programme to Enhance Talent Training for the Asset and Wealth Management Sector in 2016 to nurture talent for the asset and wealth management industry. Also, the Hong Kong Monetary Authority and the Private Wealth Management Association co-organized the Pilot Apprenticeship Programme for Private Wealth Management in 2017 to provide professional training and employment opportunities for university students interested in private wealth management work.

expand the talent pool available for FIHVs/SFOs that choose to set up in Hong Kong.

Hong Kong's Capital Markets

Hong Kong has the third-biggest capital market in Asia in terms of capitalization (following China and Japan). For reference, the Hong Kong Stock Exchange's capitalization was $4.6 trillion as of December 2022, China's was $11.4 trillion, Tokyo's $5.4 trillion, and Singapore's $0.6 trillion.[11] While there is no requirement for an FIHV to invest in any local Hong Kong stocks and securities, Hong Kong nevertheless provides a wide array of investment opportunities and choices to FIHVs and SFOs that may not be able to be matched by other capital markets in Asia. Given that the Hong Kong dollar is pegged to the U.S. dollar and backed by Hong Kong's enormous foreign reserves, Hong Kong provides a stable investment environment that allows the free movement of capital. Hong Kong's core values in the rule of law and its vast pool of international professionals (financial, legal, tax, trustee, etc.) with both global and local perspectives and experience set Hong Kong apart as one of the most desirable places in which to conduct financial transactions and make investments. Finally, its proximity to the Chinese mainland (and being part of China) enables Hong Kong to be in the unrivaled, enviable position to facilitate cross-border financial transactions and investments with the Chinese mainland.

In addition, Hong Kong is one of the world's largest equity fund-raising centers and has been the largest center for arranging Asian international bond issuance for six consecutive years. Hong Kong also serves as the world's largest offshore renminbi hub.[12] Many Chinese companies have expanded to the rest of the world using Hong Kong as a springboard, and similarly, overseas companies prefer to invest in the Chinese mainland market via Hong Kong.

Conclusion

As wealthy families become more global in their investment strategies and lifestyle preferences, Hong Kong is uniquely positioned as an international financial center that can provide families with both vast global investment opportunities and the ease with which to fund and manage their international lifestyles. The new FO regime is widely perceived to be a favorable and necessary framework within which global FOs can develop and thrive. Most would agree that Hong Kong's new regime has checked the five boxes outlined above, making Hong Kong a highly competitive and preferred FO location.

Moreover, judging from the amount of inquiries from potential clients, the business and professional community is optimistic that many of the world's families, in particular those from Asia, will choose Hong Kong to set up their SFOs. The new regime will further reinforce and accelerate a virtuous cycle that is already in motion: More financial and human capital inflows into Hong Kong and more economic benefits to Hong Kong's economy in turn magnify the benefits of Hong Kong as the undisputable FO hub in Asia and beyond. ■

[11] Data collected from Ceic Data.

[12] About 75 percent of the global offshore renminbi payments were processed via Hong Kong in 2019 with an average daily turnover of Hong Kong's renminbi real-time gross settlement system reaching over CNY 1.1 trillion in December 2019.