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Mr Joseph H L Chan JP
Under Secretary for Financial Services & the Treasury
Room 2405, Central Government Offices
Tamar, Hong Kong

By email: fund-consultation@fstb.gov.hk

Dear Under Secretary

CPA Australia's submission on the consultation on preferential tax regimes for privately-offered funds, family-owned investment holding vehicles and carried interest

CPA Australia represents the diverse interests of over 173,000 accounting and finance professionals working in 100 jurisdictions and regions globally, including over 16,000 members in Hong Kong. We make this submission on behalf of our members and in the broader public interest.

We support the direction of the proposed changes in the consultation paper. They should improve the existing preferential tax regimes for the asset and wealth management industry, and in so doing, attract more funds and family offices to Hong Kong. However, there are several key areas that require further consideration to improve the regime's competitiveness and further support the industry's growth.

We make the following summary comments and key points for your consideration. Please refer to the Appendix for our detailed discussion:

- We propose the explicit inclusion of "fund of one" arrangements in the definition of "fund" under the unified tax regime for funds (UFR) framework. This arrangement functions similar to other investment schemes and would ensure equitable treatment of all investment arrangements.
- We support the expansion of permissible assets to include loans, private credit investments, and virtual assets. However, we recommend that loans and private credit investments not be subject to additional tests, and that the definition of these assets be broad enough to cover diverse lending arrangements.
- We recommend including artwork, antiques, and collectibles as permissible assets.
- Regarding what income is eligible for profits tax exemption, we recommend against implementing an exclusion list, as it may create confusion in practice. We advocate for a simplified tax framework that enhances clarity for all stakeholders.
- While we support the removal of the control test and short-term asset test, we express concern that this may narrow the scope of eligible investments. Therefore, we propose relaxing the immovable property and holding period tests to maintain a broader range of qualifying investments.
- We recommend extending the proposed simplified tax reporting mechanism to Funds with Special Purpose Entities (FSPEs) and Family-owned Investment Holding Vehicles (FIHV) with FSPEs. This would streamline reporting requirements.

Our responses to the questions raised in the consultation paper are included in the **Appendix**. Should you have any questions, please contact Ms Samantha Yim at CPA Australia at samantha.yim@cpaaustralia.com.au .

Yours sincerely,

Karina Wong FCPA

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Appendix

Responses to specific questions

3.3.1-3.3.3 Definition of fund

We propose including arrangements with a single investor, commonly referred to as a "fund of one," in the definition of a “fund”. This inclusion would provide clarity and certainty that such arrangements are recognised within the definition.

A fund structure with only one investor often arises from commercial considerations, where the investor prefers to have their substantial capital managed separately by a fund manager for greater efficiency. Essentially, this arrangement functions similarly to other investment schemes, with the primary distinction being the presence of a single investor driven by commercial motivations. Therefore, recognising it within the definition of *fund* would provide much-needed clarity and consistency in regulatory compliance, ensuring equitable treatment of all investment arrangements under the UFR.

3.3.6 Qualifying Investments

We support the proposed expansion of the scope of permissible assets to include loans and private credit investments. This is commendably generous and aligns well with the current investment preferences of funds and family offices.

We recommend that the government confirm that loans and private credit investments not classified as “securities,” should *not* be subject to additional tests such as the immovable property test and the holding period test. Under the existing regime, tax concessions for transactions involving “specified securities” (including shares, stocks, debentures, loan stocks, funds, bonds, or notes) issued by private companies are subject to these additional tests.

Further, we suggest that the government ensure that the definition of “loans and private credit investments” is sufficiently broad to encompass various types of lending arrangements, including those without formal lending agreements.

We also propose expanding the scope of permissible assets to include artwork, antiques, and collectibles; provided they are traded through or evaluated by auction houses in Hong Kong.

Hong Kong is one of the world’s top three art trading centres, with the total trade value of works of art, collectors’ pieces, and antiques reaching approximately HK$105.5 billion in 2023[1]. This proposed expansion should enhance the single-family office tax concession regime and further solidify Hong Kong's position as a leading art trading hub.

Our members have observed that art and collectibles is an increasingly important component of the investment portfolios of funds and family offices. By broadening the permissible assets as suggested, the Hong Kong regime would attract a larger group of targeted investors, such as art collectors, and stimulate the local art auction and transaction market. Additionally, this change would enable corresponding virtual assets, such as NFTs - cryptographically secured digital representation which provides a holder with an interest in the underlying artwork - to qualify as investments, further enhancing the regime's appeal.

[1] HKSAR (2024), https://www.info.gov.hk/gia/general/202407/01/P2024063000424.htm

3.3.7-3.3.9 Income eligible for profits tax concession

We support the proposed expansion of the scope of permissible assets to include virtual assets.

We recommend that the government confirm that all forms of income derived from virtual assets - such as staking income - should be eligible for tax concessions, provided the virtual assets qualify as permissible assets. Given that investment vehicles focused on virtual assets often generate various types of income beyond mere trading gains, this clarification would enhance the attractiveness of Hong Kong's investment landscape and support this emerging sector's growth.

We also suggest that the government refrain from implementing an exclusion list for income eligible for profits tax exemption. Given that income derived from private companies engaged in property trading or development of immovable properties in Hong Kong is likely already excluded under the immovable property test for qualifying investments, introducing an exclusion list could lead to duplication or confusion in practice. Therefore, we believe that eliminating this exclusion list would simplify the tax framework and enhance clarity for all stakeholders involved.

3.3.10-3.3.12 Definition of special purpose entities (SPE)

We support the proposed expansion of the scope of SPEs activities. To further enhance the attractiveness of the regime, we suggest the government expand the scope of SPE's activities to include "managing" the permissible assets as well.

This flexibility would enable SPEs to build stronger economic substance by deriving active service income from the management of these assets. This could be advantageous for tax treaty claims depending on the target jurisdictions, without jeopardising the tax exemption status of the SPE. It is important to note that the service income derived by SPEs from the management of permissible assets, would not be exempt from tax, and its taxability would be determined by Hong Kong's general tax rules.

While we appreciate the proposed enhancements, including the introduction of a *de minimis* rule, we believe the proposed 95 per cent threshold is excessively high. It is common for co-investors to hold more than 5 per cent in co-investment arrangements, making the current threshold unlikely to be widely applicable or beneficial for most arrangements in the market. This could undermine the primary purpose of this enhancement.

3.3.13 Tests applicable to transactions in private companies

We welcome the removal of the control test and short-term asset test. These changes will help clarify the rules for taxpayers and reduce uncertainties experienced in the past.

However, this removal may also suggest a narrowing of the scope of investments eligible for tax exemption. To address this concern, we propose that, concurrently with the elimination of these two tests, there should be a relaxation of the remaining tests, specifically the immovable property test and the holding period test.

For example, increasing the threshold for the immovable property test, allowing private companies to hold up to 50 per cent of their assets in immovable properties in Hong Kong instead of the current 10 per cent limit. This adjustment would help maintain a broader range of qualifying investments while still ensuring compliance with tax regulations.

3.3.20-3.3.22 Tax reporting and substantial activities requirement

We suggest that the proposed simplified tax reporting mechanism be extended to Funds with Special Purpose Entities (FSPEs) as well as Family-owned Investment Holding Vehicles (FIHV) with FSPEs. For instance, the FIHV could report the exempt income derived by the underlying FSPE in a supplementary form. This would eliminate the need for additional tax filing requirements for the FSPEs.

While we acknowledge that the overall direction of the consultation paper aims to enhance preferential tax regimes, the introduction of new compliance requirements may impose additional burden on the industry.

Hong Kong's profits tax exemption regime for investment funds has undergone several changes since its introduction in 2006, however it has always operated on a self-assessment basis. This means that there has been no requirement for tax reporting in Hong Kong and no substantial activities requirement. Non-Hong Kong incorporated or registered funds, such as those from the Cayman Islands, have enjoyed this exemption without needing to meet tax reporting or substantial activities requirements.

CPA Australia is supportive of improved tax transparency where appropriate. If the new reporting requirements are implemented, it is crucial to minimise the compliance burden as much as possible.

We recommend that only essential information be collected, and that standardised and simplified forms be provided for tax reporting. Additionally, we propose allowing consolidated reporting, which includes the substantial activities requirement, as an option. It is also advisable to reference the practices of other jurisdictions with similar requirements to ensure that Hong Kong's regulations remain competitive.

Acknowledgements

CPA Australia would like to acknowledge the following members for their input into this submission:

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