



Long-awaited bill enhancing tax concessions for funds, family offices and carried interest gazetted

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Issue 8

In brief

Following an industry consultation and further engagement sessions in 2024 and 2025¹, the long-awaited Inland Revenue (Amendment) (Preferential Tax Regimes for Funds, Family-owned Investment Holding Vehicles and Carried Interest) Bill 2026 (Bill)² seeking to implement the enhancements to the preferential tax regimes for privately-offered funds, family-owned investment holding vehicles (FIHVs) and carried interest will be gazetted on 12 June 2026.

We are pleased that the Government has taken on board many of the comments raised by industry during the consultation process. In our view, the enhancements proposed under the Bill should make these tax concession regimes even more attractive and help position them as best-in-class among comparable regimes in other jurisdictions.

Subject to the passage of the Bill by the Legislative Council (LegCo), the relevant measures would take effect from the year of assessment 2025/26.

This news flash summarises the enhancement measures proposed in the Bill for funds and carried interest, together with our observations on those proposals. Please also refer to our other news flash, which focuses on the enhancement measures proposed for the preferential tax regime for FIHVs³.

In detail

Enhancements to unified tax regime for funds (UFR)

Expanded definition of ‘fund’

The definition of ‘fund’ would be expanded to include certain ‘fund-of-one’ arrangements where the value of qualifying investments managed is at least HK\$240 million, and the investor does not have day-to-day control over the management of the relevant property. The expanded definition would also cover (1) pension funds, (2) endowment funds of Hong Kong tax-exempt charities, and (3) funds with a governmental entity, a central bank or an international organisation as their sole investor.

These newly in-scope funds, as well as sovereign wealth funds already covered under the existing regime (collectively, ‘excepted funds’), would not need to be managed by a specified person.

Our observations	<p>We welcome the expansion to include certain fund-of-one structures as funds qualifying for the enhanced UFR. These structures are commonly used by institutional investors and high-net-worth individuals to pursue bespoke investment objectives and tailored strategies. Although there is only one investor, such investor does not participate in the day-to-day management or control of the fund’s assets. Including such structures would not undermine the policy rationale of the enhanced UFR, given that the investor remains passive. It is therefore reasonable to allow these structures to benefit from the enhanced UFR.</p> <p>However, as funds generally take time to deploy capital for investments, we hope that further flexibility will be provided to address situations in which the value of the qualifying investments under management is below HK\$240 million during the start-up period for funds-of-one.</p>
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Broader scope of qualifying investments

The scope of qualifying investments would be expanded to cover the following assets:

(1) loans	(2) digital assets (subject to certain exclusions)
(3) overseas immovable property	(4) emission derivatives/allowance and carbon credits
(5) insurance-linked securities	(6) equity interests in non-corporate private entities (e.g. partnerships, Tokumei Kumiai)
(7) precious metals (e.g. gold, silver and platinum), provided that the investment in such metals does not exceed 20% of the total investment portfolio	(8) specified commodities, provided that (i) such trading is in connection with and incidental to trading in OTC derivative products or futures contracts, and (ii) the trade volume does not exceed 15% of the total trade volume of those commodities and related commodity derivatives

Our observations

The proposed expansion of the scope of qualifying investments to include new asset classes that have gained popularity in recent years is likely to enhance the attractiveness of Hong Kong's UFR. The exclusion of some of these asset classes from comparable tax concession regimes in neighbouring jurisdictions further accentuates the competitiveness of Hong Kong's regime.

Changes to tax exemption for funds and SPEs

- **Profits eligible for exemption:** The current 5% cap on incidental transactions would be removed. Subject to specified conditions, all profits derived by funds and their special purpose entities (SPEs) from qualifying investments would be eligible for tax exemption. An exclusion list, however, would be introduced to cover income from shares or stocks of private companies which is attributable to property trading or property development of immovable property in Hong Kong.
- **Treatment of SPEs:**
 - Full tax exemption would be granted to a fund's SPE regardless of the fund's ownership, provided that any of the co-investor(s) does not have day-to-day control over the management of the SPE's property. Co-investors would be subject to anti-round tripping provisions.
 - The scope of permissible SPE activities would be expanded to cover the acquisition, holding, administration and disposal of investee private companies, another SPE and qualifying investments, as well as activities incidental to those activities.
- **Tests applicable to transactions in private companies:** With equity interests in non-corporate private entities included as qualifying investments, the four tests would apply to transactions in, and holdings of, equity interests in private companies and non-corporate private entities, but not to debt investments in private companies.

Our observations

The removal of the 5% incidental income threshold addresses the long-standing issue of interest income being treated as incidental income and hence subject to the 5% threshold. This change will be particularly welcomed by fixed income funds. It also provides private equity funds with greater flexibility to fund their SPEs through shareholder loans, alongside capital contributions.

The enhanced full exemption treatment of SPEs should resolve the practical challenges faced by funds under the existing regime in arranging co-investment with investees' management team (i.e. setting up management incentive programme), specific limited partners and/or other third-party investors. Coupled with the proposed expansion of SPE's permitted scope of activities, the revised treatment should better accommodate the range of activities that a fund's SPE would ordinarily undertake in practice.

Anti-round tripping provisions

The following Hong Kong resident persons would be carved out from the existing anti-round tripping provisions as excluded persons: (1) natural persons, (2) exempted funds under the UFR, (3) persons who would not have been chargeable to profits tax or whose profits from qualifying investments would not have been included in their assessable profits if the assets had been held, or the transactions in those assets had been undertaken, directly by the person ('exempted person'), and (4) interposed entities meeting certain conditions.

On the other hand, specific anti-round tripping provisions would be introduced for persons who are financial institutions, insurance companies or carrying on money lending or intra-group financing

businesses in Hong Kong in respect of profits derived by funds and/or SPEs from loans. Subject to the excluded person carve-out, the provisions would be triggered if such a person: (1) owns, either alone or jointly with its associates, at least 20% of the beneficial interest in the fund or SPE, (2) has control or significant influence over the fund or SPE; or (3) is an associate of the fund or SPE.

A taxpayer subject to either the general or specific anti-round-tripping provisions would not be taxed twice on the same profits.

Our observations

The proposed exclusion of certain resident persons from the general and specific anti-round tripping provisions is welcome and reasonable. For instance, it would help address cases involving Hong Kong resident individuals, who are generally not subject to tax on their own investments. It would also help resolve issues arising in situations where an exempted fund under the UFR invests in another fund that is similarly exempted, such as a fund-of-funds structure. In addition, it would cover specific classes of taxpayers whose investment income is not subject to tax under their applicable tax regimes, such as life insurance corporations that have adopted the '5% premium method' for determining their assessable profits.

The Bill also includes provisions aimed at preventing double taxation in scenarios where taxpayers face both deemed assessable profits under anti-round tripping rules and assessable profits from distributions and/or unrealised gains from the fund.

However, the operation of the anti-round tripping provisions is complicated, particularly concerning how to determine the threshold and the deemed assessable profits as well as how the double taxation prevention rules operate in practice.

Tax reporting and substantial activities requirement

Funds and SPEs seeking profits tax exemption under the enhanced UFR would generally be required to make an initial notification and annual notification, to be undertaken by the fund manager or fund administrator, who may also delegate this task to a service provider. Funds would also need to satisfy a substantial activities requirement, though it is expected that the Inland Revenue Department (IRD) would allow the relevant activities to be outsourced to third parties or associates, similar to other concessionary regimes.

Our observations

The proposed tax reporting mechanism has raised concerns among stakeholders during the consultation stage. We appreciate that the Government has engaged extensively with the industry on this matter with a view to minimising the compliance burden. Fund managers or authorised representatives of the funds (and their SPEs if any) will only need to provide certain accounting data of the funds and SPEs concerned, as well as information showing that the tax exemption conditions and economic substance requirements are satisfied – essentially information that is strictly necessary to assess the effectiveness and compliance with the regime, without any requirements to disclose confidential information relating to the funds' investments or investors. Details of the reporting arrangements will be provided by the IRD after enactment of the legislation.

Enhancements to carried interest tax concession regime

The Bill proposes several key amendments in relation to the carried interest tax concession regime, as set out below:

- (i) Expanding the scope of transactions giving rise to eligible carried interest beyond private equity investment to cover other qualifying transactions.
- (ii) Expanding the types of profits of a fund that may give rise to eligible carried interest to include, apart from profits exempt from tax under the UFR, other non-taxable profits and other taxable profits.
- (iii) Refining the definition of 'qualifying person' to include unlicensed fund managers of excepted funds.
- (iv) Expanding the coverage of 'associate' under the definitions of 'qualifying payer' and 'qualifying employee' to include, respectively, entities within the same group of the fund and individuals employed by entities within the same group as the investment manager.
- (v) Removing the requirement that carried interest be 'paid through the qualifying person', so that qualifying employees may enjoy the salaries tax concession on eligible carried interest received directly or indirectly from qualifying payers.
- (vi) Allowing qualifying employees to enjoy the salaries tax concession on eligible carried interest received on their behalf by an entity wholly or partly owned by them.
- (vii) Removing the Hong Kong Monetary Authority certification requirement for funds.
- (viii) Removing the reference to a hurdle rate from the definition of 'eligible carried interest'.

However, the meaning of 'eligible carried interest' would be refined by introducing safeguard measures aimed at preventing abuse, including:

- requiring a qualifying person or qualifying employee to have a specified right in respect of a fund's profits, which is determined in accordance with certain agreement;
- requiring that a qualifying person's or qualifying employee's entitlement to receive a share of the fund's profits is non-discretionary but may allow a degree of flexibility on some aspects (e.g. amount, timing, etc.); and
- excluding certain sums or amounts where they are, in substance, management fees disguised as eligible carried interest, with the significant risk test assessed by reference to the terms of the arrangement and the volatility of the investments.

Our observations

With the refined definition of 'eligible carried interest', some uncertainty remains as to whether carried interest distributed in certain scenarios would qualify. For example, it is not readily clear:

- how 'specified right' can be demonstrated;
- how genuine carried interest can be differentiated from discretionary bonus;
- what degree of flexibility is allowed;
- whether exemption is available where the fund as a whole is loss-making but carried interest is distributed by reference to a profitable portfolio managed by the recipients;
- how would transfer pricing arrangement between an overseas manager and a Hong Kong sub-manager affect the eligibility of exemption in a multi-managers scenario; and
- how eligible carried interest accrued before 1 April 2025 but not yet received should be treated.

Hopefully, the IRD will provide guidance addressing these issues in due course. Recipients are also recommended to seek advice on their existing carried interest distribution arrangements and related documentation to assess their eligibility for the concession.

The takeaway

The proposed changes to the UFR and preferential tax regime for carried interest are game-changing, as they would substantially expand the scope of the tax concessions and are expected to allow more industry participants to qualify for them. These substantial changes are also expected to strengthen Hong Kong's competitiveness as an international asset and wealth management centre. That said, taxpayers should be mindful that the qualifying criteria involve detailed conditions that must be carefully assessed. Professional advice should therefore be sought when reviewing whether the relevant concessions are applicable.

Endnotes

1. Our news flashes on the consultation paper can be accessed via these links:
<https://www.pwchk.com/en/services/tax/publications/hongkongtax-news-nov2024-19.html>
<https://www.pwchk.com/en/services/tax/publications/hongkongtax-news-nov2024-20.html>
2. The Bill is included as Annex A to the relevant LegCo brief, which can be accessed via this link:
https://www.legco.gov.hk/yr2026/english/brief/asst315c2026_20260610-e.pdf
3. Our news flash on the proposed enhancements to the FIHV tax concession regime can be accessed via this link:
<https://www.pwchk.com/en/services/tax/publications/hongkongtax-news-jun2026-9.html>

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Hong Kong Tax News Flash

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