When family offices meet funds

This article discusses why family offices are gravitating towards pooled investment vehicles in managing their assets. Because, the chemistry is undeniable.

The needs of the ultra-high net-worth have since evolved from simply assets preservation and succession planning to a more active, institutional-like desire to grow what they own. This is down to reasons such as the emergence of new generations with new ideas, as well as a whole new range of investment and risk management opportunities. Also, family offices increasingly see the advantages of streamlining management to optimise economies of scale and expertise-sharing. Plus, using pooled investment vehicles minimizes the potential of family disputes as it removes the responsibility of, among other things, managing the assets from the family itself.

How are investment funds different for family offices

No different from institutional asset managers, family offices use different vehicles - such as limited partnerships, companies and unit trusts - for different strategies to drive portfolio returns.

A key difference between family offices and institutional investment funds is that the objective and mandate are driven by the ultimate principal(s) of the single or multiple-family offices (MFOs), even though some MFOs may choose to be led by an investment committee. From our experience, investments are often made quickly, with family offices more open to exploring new or even bespoke structures. For instance, we helped one family office make a swift decision to incorporate a Hong Kong limited partnership fund. The quick and hassle free set-up then allowed it to seize an immediate investment opportunity.

Subject to each family office's liquidity needs, they are also more flexible on exit strategies compared to institutional investment funds. While there are always ad hoc short-term investment aims, family offices often look to invest across generations over a much longer holding period, and their objectives sometimes lie beyond financial return. For instance, investments may arise from family ties, or shared passions such as fine arts and wine. This also explains why family offices are leading the way in the ESG-related investments space, a perfect example being the RS Group, a family office pioneer in sustainability investments.

Vehicles with the edge in tax

Different structures offer various tax incentives and advantages, based on factors such as the jurisdiction of investors, managers and underlying investments.

(a) **Partnerships** – Partnerships in certain jurisdictions are considered tax transparent, which means that profits will be taxed at the investor level, not fund level. Depending on the applicable tax rates of investors, partnerships are typically tax-favourable.

(b) **Cayman Islands** – There are currently no income, capital gain or other direct taxes levied on typical Cayman fund vehicles such as the exempted limited partnership (ELP) and limited liability company. Funds can apply for an undertaking from the government to exempt the fund from any tax on profits for a period of 20 years, or 50 years for ELPs.

(c) **Hong Kong** – The city provides several tax incentives aimed at Hong Kong-based funds, including:

- **Funds Profits Tax Exemption Scheme** – This exempts certain profits earned by funds from Hong Kong profits tax, subject to conditions. Such funds must either be a qualified investment fund meeting prescribed conditions, or executing a transaction carried out or arranged by licensed persons under the Hong Kong securities law. There are also provisions for tax exemption of incidental transactions - up to 5% of the total trading receipts - from qualifying transactions. However, the scheme does not apply to investments in Hong Kong real estate or short-term assets.

- **Tax Concessions for Carried Interest** – This allows carried interest on private equity earned by or accrued to qualifying entities - such as the management company and employees - for investment management services provided by them to funds to be taxed at 0%. To be eligible, such funds must satisfy certain conditions and be certified by the Hong Kong Monetary Authority.

- **OFC Grant Scheme** – The Securities and Futures Commission offers a subsidy of up to 70% of eligible expenses tied to the incorporation of open-ended fund companies (OFCs), capped at HK$1,000,000 per OFC. The scheme is due to expire 9 May 2024, subject to availability of budget.

- **Proposed Tax Concessions for Single-Family Offices** – Hong Kong's government proposed in its 2022/23 Budget tax concessions for eligible family investment management entities managed by single family offices, with industry consultation for the plan set to end 8 April 2022. Under the proposal, a family-owned investment holding vehicle managed by a single family in Hong Kong, subject to requirements, may be exempted from tax on profits derived from qualifying transactions and incidental transactions (up to a 5% threshold, similar to the Funds Profits Tax Exemption Scheme described above).

(d) **Singapore** – The city state maintains a number of tax incentives targeted at Singapore-based funds and fund managers, including:

- **Onshore Fund Tax Exemption Scheme (13O/13R Scheme)** – This sets out that a fund in the form of a company incorporated and resident in Singapore, such as variable capital companies (VCCs), may apply for tax exemption on specified income derived from designated investments. This is subject to conditions including: (i) the fund must be managed by a Singapore fund manager, (ii) the fund cannot be wholly beneficially-owned by Singapore persons, and (iii) the fund must incur at least S$200,000 in local business spending per year. There is a similar Offshore Fund Tax Exemption Scheme (13D/13CA Scheme) that applies to offshore corporate funds managed by Singapore managers, and an Enhanced Tier Fund Tax Exemption Scheme (13U/13X Scheme) that applies to funds with a size of at least S$50 million managed by Singapore managers (regardless of whether the fund is corporate or partnership; onshore or offshore). Different conditions apply.

- **Venture Company Tax Exemption (13G/13H Scheme)** – Available till end-2025, this sets out that authorised investments in unlisted Singapore companies made by approved VC funds, including VCCs, may be exempt from tax for up to a maximum of 15 years. It is not limited to funds domiciled in Singapore.

- **Financial Sector Incentive Scheme** – Under the plan, a concessionary tax rate of 5% or 10%, depending on the types of qualifying funds, may apply to fee income earned by an approved Singapore fund manager for providing fund management or investment advisory services to a qualifying fund in respect of designated investments. This may also extend to Singapore fund managers managing qualifying offshore funds.

- **GST Remission** – Funds, such as VCCs, may incur goods and service tax when they procure services from GST-registered businesses. Entities that meet qualifying conditions have till 31 December 2024 to claim the GST incurred.

- **VCC Grant Scheme** – This subsidy scheme aims to offset 70% of qualifying expenses tied to the incorporation and registration of VCCs, such as legal, tax and regulatory compliance service fees. It is capped at S$150,000 per VCC and valid till 15 January 2023.

In short, with the range of options and benefits available in the market, there is arguably no better time for family offices, or ultra-high net-worth in general, to develop their use of pooled investment vehicles. Feel free to contact us for further discussion.

Get in touch

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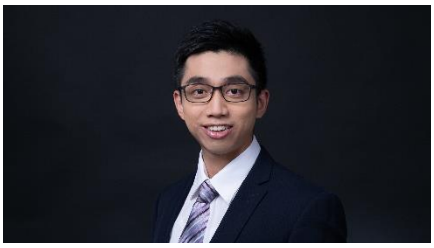

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