

Hong Kong SAR Tax Alert

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Hong Kong SAR unveils draft law to enhance the Unified Funds Exemption and the Carried Interest concession

Summary

Hong Kong's latest reforms to its Unified Fund Exemption regime ("UFE") and carried interest incentive mark a major milestone in the city's ongoing strategy to cement its position as Asia's leading asset and wealth management hub. The expanded UFE significantly widens the scope of Hong Kong's fund tax regime, extending meaningful tax certainty and efficiency to virtually all major asset management strategies, including private credit and debt, virtual assets, real estate funds, private equity, hedge funds and a broad range of alternative investments.

At the same time, the introduction of an effective tax exemption for carried interest and performance fees – not only for managers and general partners, but also for employees who are directly involved in relevant asset management activities – represents a ground-breaking enhancement to Hong Kong's competitiveness as a domicile for investment management businesses.

Together, these measures are expected to stimulate strong interest from regional and global asset managers seeking a robust, business-friendly platform from which to deploy capital, build investment teams and oversee assets across Asia. They also underline the Hong Kong Government's clear commitment to maintaining and enhancing the city's role as a gateway between Chinese Mainland and international markets, leveraging its deep capital markets, international connectivity, sophisticated private wealth ecosystem and access to diverse regional investment opportunities.

Against this backdrop, the new tax incentives are poised to provide a powerful boost to the continued growth and evolution of Hong Kong's asset management industry, and will be a central focus of this publication's analysis.



Background – the Bill

The Inland Revenue (Amendment) (Preferential Tax Regimes for Funds, Family-owned Investment Holding Vehicles and Carried Interest) Bill 2026 ("the Bill") was published in the Gazette on 12 June 2026. The Bill sets out the detailed draft legislation for implementing the enhanced tax concessions for family-owned investment holding vehicles ("FIHVs"), funds and carried interest. Subject to the enactment of the Bill, the enhanced tax concessions will take retrospective effect from 1 April 2025 (i.e. from the year of assessment 2025/26).

In this tax alert, we discuss the key enhancements to the tax concessions for funds and carried interest and share our observations.

Key enhancements to the Unified Funds Exemption (UFE)

1. Expansion of the definition of "fund"

At present, the definition of "fund" under the UFE regime specifically includes sovereign wealth funds. However, pension funds are not explicitly included and, depending on their structure and arrangements, may not qualify as a "fund".

In the Bill, the definition of "fund" is expanded to include:

- pension funds;
- endowment funds of section 88 charitable institutions;
- single-investor funds where the sole investor is a governmental entity, central bank or international organisation; and
- single-investor arrangements with:
 - at least HK\$240 million in qualifying investments; and
 - the investor not having day to day control over management.

These changes are aimed at common institutional and ultra-high-net-worth bespoke "fund-of-one" structures.

In addition, the newly scoped-in funds described above, as well as sovereign wealth funds (collectively "excepted funds"), do not need to be managed by a specified person.

The legislation also clarifies that transacting in, or earning profits from, qualifying investments alone does not make an entity a business undertaking for general commercial or industrial purposes. This will prevent funds from being inadvertently treated as non-fund businesses (and thus ineligible for tax exemption) simply because they carry on investment activities in qualifying investments.

2. Expanded scope of qualifying investments

The UFE applies to qualifying investments as defined in Schedule 16C of the Inland Revenue Ordinance ("IRO"). These include transactions in securities, futures contracts, foreign exchange contracts, the making of a deposit other than by way of a money-lending business, deposit-making with a bank, certificates of deposit, foreign currencies, exchange-traded commodities, over-the-counter ("OTC") derivative products, an investee company's shares of an ITVFC co-invested by a partner fund, and shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a private company which does not hold (directly or indirectly) (i) immovable property in Hong Kong, or (ii) share capital in another private company that holds (directly or indirectly) immovable property in Hong Kong.

The Bill expands the scope of Schedule 16C assets to include the following assets:

- equity interests (direct or indirect) in non-corporate entities (e.g. partnerships);
- loans;
- immovable property situated outside Hong Kong;
- digital assets;

- insurance-linked securities;
- precious metals (with value not exceeding 20% of the investment portfolio);
- certain commodities in connection with and incidental to the trading of OTC derivative products; and
- emission derivatives/allowances and carbon credits.

Notably, the provision of loans will now be included in the scope of qualifying investments under the UFE regime, and the corresponding interest income derived from the provision of loans should be exempt.

The inclusion of loans as qualifying investments is a significant development for private credit and debt funds, given the substantial growth in recent years as investors have become increasingly interested in funds focusing on alternative private credit strategies.

Overall, these changes offer enhanced certainty and flexibility for structuring private asset investments, further consolidating Hong Kong's position as a premier asset management hub in the region.

3. Removal of the 5% threshold for incidental transactions

The Bill removes the references to "qualifying transactions" and "incidental transactions", as well as the 5% threshold for incidental transactions. As the tax concession is now granted to assessable profits derived from the holding of or transactions in Schedule 16C assets instead of merely "transactions in" Schedule 16C assets, these terms and the 5% threshold are no longer relevant.

The 5% threshold has traditionally been an issue for funds investing in loans and debt-type investments, where the interest income is considered as "incidental income" and unable to rely on the exemption when the 5% threshold is exceeded. This is a welcome development and is consistent with the expansion of qualifying investments to include loans and private credit, where funds are expected to mainly derive interest income.

4. SPE permissible activities

The UFE applies to gains made by funds directly, as well as gains made through special purpose entities ("SPEs") held by the funds.

Under the current UFE regime, the restricted scope of permissible activities of an SPE creates a level of uncertainty and concern because an SPE could potentially lose its exemption status if it performed functions that went beyond what was considered as holding and administering the investment in a private company.

Under the enhanced UFE regime in the Bill, the range of permissible activities for SPEs is expanded, allowing them to undertake typical functions related to the acquisition, holding, administration and disposal of investee private companies and/or interposed SPEs, and activities incidental to those activities.

This legislative update is likely to cover most typical investment-related business activities of an SPE, including (but not limited to) holding debt investments, and the profits therefrom are expected to be exempt.

5. Co-investment at SPV level

Under the current UFE regime, the tax exemption of an SPE's profits is limited to the portion that corresponds to the percentage of equity interest that a tax-exempt fund holds in the SPE. This could potentially be an issue for a non-tax-exempt-fund co-investor.

To address uncertainty in co-investment holding structures, a new rule is introduced in the revised UFE regime. In particular, the tax exemption will cover all of the SPV's profits derived from Schedule 16C assets, irrespective of the tax status of the co-investor and regardless of the percentage of beneficial interest in the SPV held by the fund, as long as the SPV qualifies as an SPE. This is subject to the anti-round tripping rules discussed below.

This is a welcome development as it provides tax certainty to the fund and the co-investor(s).

6. Private company tests

The current UFE regime requires a series of conditions for exemption on gains from private company exits, including the "immovable property", "two-year holding period", "control" and "short-term asset" tests.

In the Bill, the four tests (previously applicable to shares in private companies) are updated and extended to equity interests in private companies and non-corporate private entities (for example, partnerships, business trusts and TK/GK structures).

7. Reporting obligations and substance requirements

In the past, the UFE regime operated on a self-assessment basis, where funds that qualified for the UFE did not have to carry out any tax reporting in Hong Kong. The Bill introduces a new, but purposefully targeted, reporting framework for funds and their SPEs that intend to rely on the enhanced UFE.

For the initial notification, an initial notification would need to be filed with the IRD within six months from the date the specified person has started to manage or administer the fund. A fund can appoint (designate) one specified person in Hong Kong to handle this obligation.

Based on the draft tax reporting template under the enhanced UFE regime, the IRD intends to adopt a “light-touch” approach and to apply the reporting only to funds (and their SPEs, if any) which claim or intend to claim profits tax exemption under the enhanced UFE regime (i.e. Relevant Funds and Relevant SPEs). Other data points include:

- SPE particulars
- Financial data (e.g. AUM, profit or loss of the Relevant Funds and Relevant SPEs)
- Whether the UFE eligibility conditions are met
- Whether the substantial activities requirements are met; and
- Whether the anti-round tripping tests are applicable.

To reduce duplication, the regime is designed to allow aggregate reporting of core financial and substance metrics across funds and SPEs managed by the same manager, rather than requiring separate, granular filings for each entity.

The new reporting obligations will first apply from the year of assessment 2025/26 (commencing 1 April 2025). Recognising that this represents a change in practice, the Government has indicated that a transitional arrangement will be introduced to extend the filing deadline for the first implementation year, giving managers additional time to adapt their systems and processes. The IRD is expected to issue detailed guidance and forms setting out the precise content, format and timing of the annual notification after the amendment ordinance is enacted.

8. Economic substance conditions

To enjoy exemption, the fund is expected to demonstrate adequate Hong Kong substance, typically requiring at least an average of two (2) full-time qualified employees in Hong Kong performing core income-generating activities and at least HK\$2 million of annual operating expenditure incurred in Hong Kong in relation to investment and management activities.

These thresholds can be satisfied at the level of the fund, the manager and/or related entities as permitted under the detailed rules. Investment managers and advisers should ensure that their funds have appropriate systems, resources and processes in place to meet these requirements. This includes coordinating with fund administrators, legal counsel and tax advisers to develop a robust reporting infrastructure aligned with the anticipated rules, and reassessing this framework once the final legislation and guidance are released.

9. Additional non-qualifying income and revised anti-round tripping rules

Besides the above key enhancements, the Bill also introduces (i) new exceptions to the tax concession and (ii) revised anti-round tripping rules as follows.

New exceptions to the tax concession

As discussed, the expanded UFE significantly widens the scope of Hong Kong’s fund tax regime, encompassing virtually all major asset management strategies.

To enhance tax certainty and avoid disputes, the Bill introduces an exclusion list whereby income specified in the list will not qualify for the tax exemption. Currently, the Bill specifies that income derived by a fund or SPE from a private company that engages in (i) property trading, or (ii) property development of immovable property in Hong Kong is not eligible for the tax concession.

Relaxation of anti-round tripping provisions

The current UFE includes anti-round tripping provisions that can deem certain Hong Kong residents investing in a fund to be taxable. Hong Kong resident investors could be deemed as deriving Hong Kong-sourced taxable income in respect of their interest in a fund, where the fund has derived taxable income that is exempt from tax under the UFE.

In another welcome development, these anti-round tripping provisions are being reformed so that the following persons or entities will be **excluded** from both the general and specific anti-round tripping provisions (collectively, “excluded persons”):

- natural persons;
- a fund that is eligible for the tax concession;
- a person who:
 - (i) would have been exempted from tax in respect of profits derived from Schedule 16C assets; or
 - (ii) would not have included the profits derived as its assessable profits, if the assets had been held, or the transactions in those assets had been undertaken, directly by the person in the same manner as that of a fund; and
- an entity (i) that is not a business undertaking for general commercial or industrial purposes, (ii) that does not carry on a trade or business in Hong Kong and (iii) with at least 95% of its beneficial interest owned by a non-resident person or a person that is carved out from the anti-round tripping provisions.

Specific anti-round tripping rules

The Bill introduces new specific anti-round tripping provisions for funds. In particular, the tax-exempt profits of a fund derived from loans (and related income) are deemed as assessable profits of a person who is a financial institution, an insurance company or a money lender if the person:

- (i) has, either alone or jointly with its associate(s), not less than 20% beneficial interest in a fund, or
- (ii) has control or significant influence over a fund, or
- (iii) has any beneficial interest in a fund and is an associate of the fund.

Key enhancements to the carried interest tax concession

The Bill also introduces significant enhancements to the carried interest incentive. This streamlining is intended to make the regime more accessible in practice and to encourage a wider range of funds and managers to utilise Hong Kong as a base for their carried interest and performance fee arrangements.

The Bill significantly broadens the scope of income that can qualify for the incentive. Eligibility is no longer confined to profits from private equity transactions exempt under the UFE. The new carried interest incentive will now extend to profits arising from all asset classes specified in Schedule 16C that fall within the UFE, as well as other non-taxable income such as dividends and offshore income, and even taxable income.

Carried interest arising from a qualifying fund, including performance fees commonly seen in hedge fund structures, can now fall within the exemption, provided the relevant conditions are satisfied. This means that both traditional private equity-style carry and performance-linked incentive fees in other strategies may be treated in a similar manner from a tax perspective, aligning the regime with the commercial reality of how managers are compensated across different asset classes and strategies.

The application of the exemption operates at multiple levels within the fund and manager structure. At the manager or general partner level, the tax concession can apply to the entity that is legally entitled to receive carried interest under the fund documentation. In addition, the regime extends to employees who have a contractual right to share in carried interest or performance fees, whether directly or through carried interest vehicles or profit-sharing arrangements. This is particularly important for attracting and retaining investment professionals, as it allows key team members to benefit from the same tax treatment as the manager or general partner on their performance-based rewards.

To qualify, several substantive conditions must be met. First, the carried interest must constitute “eligible carried interest”, meaning it is derived from gains generated by the fund that are either exempt under the UFE regime or taxable gains within the Hong Kong tax net. This ensures that the concession is tied to genuine investment performance rather than fixed or guaranteed returns.

Second, the rights of the manager, general partner or other qualifying recipient to participate in carried interest must be clearly set out in the Limited Partnership Agreement, fund constitutional documents or management agreement. This formal documentation requirement provides transparency and supports the integrity of the regime. Finally, the entitlement is assessed on the basis of the legal right to receive carried interest, rather than the timing of distributions, so that the focus remains on genuine participation in the economic upside of the fund.

These reforms collectively create a compelling opportunity for Hong Kong. By offering a clear, competitive and commercially aligned tax treatment for carried interest and performance fees, Hong Kong strengthens its proposition as a preferred location for establishing and expanding asset management platforms. The regime not only supports existing private equity and hedge fund managers, but also positions the city to attract new entrants and investment talent who are evaluating regional hubs across Asia. In doing so, it reinforces Hong Kong’s ambition to remain a leading centre for asset and wealth management and a key gateway for capital flows in the region.

Implementation timeline

The Bill will be introduced into the Legislative Council on 24 June 2026. Upon enactment of the Bill, the enhanced tax concessions for the UFE and the carried interest concession will be effective retrospectively from 1 April 2025 (i.e. from the year of assessment 2025/26).

To facilitate taxpayers with a December or March accounting year-end to elect for the tax concession under the enhanced tax concessions for the UFE and the carried interest concession that is pending enactment when they file their 2025/26 profits tax returns, the IRD has announced a transitional administrative measure on its website stating that taxpayers who are eligible for the tax concession under the enhanced regime proposed in the Bill can submit their 2025/26 profits tax returns on such basis despite the Bill has not yet been enacted into law.

KPMG observations

The Bill delivers enhanced clarity and certainty for asset managers, notably by expanding the definition of “fund” to include pension funds, endowment funds and single-investor funds, and by broadening the scope of qualifying investments to cover private credit, loans, non-corporate entities, digital assets and other alternative asset classes. Importantly, the reforms address longstanding industry concerns by permitting SPEs to undertake a wider range of investment activities and by extending the tax exemption to all profits of qualifying SPEs derived from Schedule 16C assets, regardless of co-investor status. The draft Bill also introduces refined anti-round tripping rules, coupled with targeted carve-outs for low-risk investors, and establishes a structured annual reporting framework and holistic substance requirements.

The Bill also introduces significant enhancements to the carried interest incentive. Key enhancements include the expansion of eligible carried interest sources beyond private equity to all asset classes under the UFE regime, increased flexibility in payment flows to qualifying employees, removal of the hurdle rate requirement, elimination of the HKMA fund certification and auditor’s report processes, and greater alignment of the regime with commercial fund structures. These reforms, which will also apply retrospectively from 1 April 2025 once enacted, address longstanding industry concerns by eliminating restrictive requirements and aligning the regime more closely with market practice.

Hong Kong’s enhanced UFE regime solidifies its status as a premier global asset management hub. While the updated rules bring new reporting duties, the streamlined framework offers fund managers greater operational clarity and tax certainty, creating highly compelling advantages for private credit and debt platforms.

Looking ahead, the government’s strong emphasis on clarity, simplicity and commercial practicality is set to further reinforce Hong Kong’s status as a leading asset management hub in the region. The reforms are expected to boost confidence in Hong Kong’s tax environment and enhance its attractiveness to fund managers and investors across a wide spectrum of strategies, with particularly compelling advantages for private credit and debt platforms.

If you have any questions or require any assistance regarding the above development, please feel free to contact us via taxservicesenquiry@kpmg.com.

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