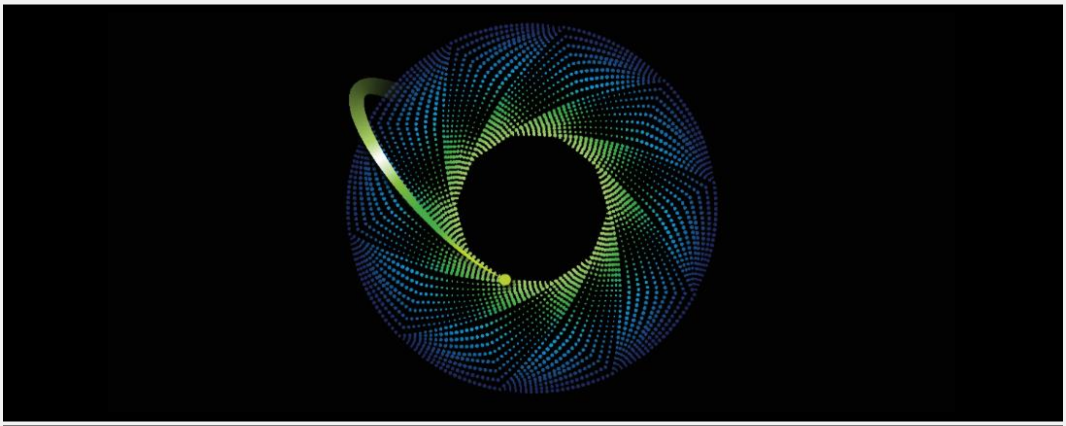
Hong Kong | Tax & Business Advisory | 11 November 2022 | Issue 163



Hong Kong Tax Newsflash
Proposed amendments to the draft legislation for foreign-sourced income exemption (FSIE) regime

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Shortly after the introduction of the Bill[1] regarding foreign-sourced income exemption (FSIE) regime in late October 2022, the European Union raised its concerns regarding certain exclusions of covered taxpayers in the Bill. In this regard, the Hong Kong SAR government proposed to make some amendments to the Bill.

In this article, we highlight the proposed amendments. For the features of the FSIE regime, please refer to our [Hong Kong *Tax Analysis Issue H110/2022*].

Proposed amendments to the FSIE regime

Excluded entities modelled on the Global Anti-Base Erosion (GloBE) rules

In the original Bill, specified entities with reference to the definition of "excluded entity" (e.g. investment fund, insurance investment entity, pension fund etc.) are excluded from the FSIE regime. As the EU does not agree with such carve-out, the relevant provisions will be removed from the Bill.

Taxpayers benefitting from the preferential tax regimes

In the original Bill, taxpayers benefitting from the existing preferential tax regimes can be excluded from the FSIE regime. Such exclusion will be switched from an "entity approach" to an "income approach". Interest, dividend and disposal gain derived from or incidental to the carrying out of profit producing activities under a preferential tax regime[2] will be excluded from the FSIE regime.

The Inland Revenue Department (IRD) will issue further guidance in relation to the proposed amendments.

Our comments

The combined effect of the above proposed amendments is that no excluded entity will be specified in the Bill. Nevertheless, there will not be much impact to the affected taxpayers (except insurance investment entity) because they would still be exempted from tax under the other provisions of the Bill and the existing provisions of the Inland Revenue Ordinance. For example, the vast majority of investment funds are not required to prepare consolidated financial statements and hence are not MNE entities as defined under the FSIE regime that fall within the scope.

Since none of the existing preferential regimes in Hong Kong cover intellectual property income, there will be no material impact on switching to an "income approach" for taxpayers benefitting from the preferential regimes. Having said that, the proposed amendment may create an uncertainty on whether a foreign-sourced specified income would be considered incidental to the profit producing activities under a preferential tax regime in order to qualify for exclusion from the FSIE regime. We hope the IRD will provide clarification in its guidelines.

[1] *Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Bill 2022*

[2] Include aircraft lessors and aircraft leasing managers, ship lessors and ship leasing managers, ship operators, corporate treasury centres, captive insurers, professional reinsurers, specified insurers, licensed insurance broker companies, eligible taxpayers under carried interest regime and unified fund exemption regime.

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