



## Hong Kong Tax Newsflash

### Consultation on refinements to Foreign-sourced Income Exemption (FSIE) regime for disposal gains launched

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The Hong Kong Government recently released a consultation paper on the proposed refinements to the FSIE regime for foreign-sourced disposal gains in order to bring it in line with the latest guidance on FSIE regimes promulgated by the European Union (EU).

As a recap, Hong Kong is still on the EU's watchlist notwithstanding that it has already implemented the FSIE regime at the beginning of this year, as the EU has updated the guidance on FSIE regimes and considered that the scope of foreign-sourced disposal gain under Hong Kong's FSIE regime is not sufficiently wide. As such, Hong Kong is required to amend its FSIE regime with respect to the disposal gains by the end of 2023. For details of the background, please refer to [Hong Kong Tax Newsflash \(Issue 174\)](#).

#### Proposed refinements on disposal gains

##### Covered assets

In response to the EU's updated guidance that any disposal gains should be considered relevant regardless of whether the assets are financial or non-financial in nature, the Hong Kong Government proposed to adopt a definite and exhaustive list of covered assets as follows:

- Shares or equity interest (*which have already been covered in the existing FSIE regime*);
- Debt instruments;
- Movable properties;
- Immovable properties;
- Intellectual properties (IP); and
- Foreign currencies.

The EU indicated that a non-exhaustive list of assets is needed and therefore the above approach is subject to negotiation.

### Exemption or relief

The following exemption or relief measures are proposed:

- **Disposal gains for traders**

Disposal gains on assets as part of the trader's income derived from substantial business activities in Hong Kong would be carved out from the refined FSIE regime.

While concerns may arise on the requirement of local substantial business activities for foreign-sourced trading profits, the Inland Revenue Department (IRD) will provide more guidance on the definition of “traders” and “substantial business activities” in due course.

- **Intra-group transfer relief**

Tax on disposal gains could be deferred if the asset is transferred between associated companies, i.e. being beneficial owner of not less than 75% of the issued share capital of the other company or a third company is the beneficial owner of not less than 75% of the issued share capital of each company, subject to certain anti-avoidance measures.

### Computation of disposal gains or losses

A rebasing approach was proposed to rebase the cost of assets to the date on which the refinements to the FSIE regime take effect, but the EU has raised concerns over the grandfathering effect of the rebasing approach.

As an alternative, the Hong Kong Government is exploring a taper relief, which would reduce the taxable amount of disposal gains according to the length of holding the assets.

### Other features

- The exemption of foreign-sourced disposal gains on IP assets will be subject to the nexus approach, instead of economic substance test. Only patents are qualifying IP assets under the nexus approach.
- Under the existing FSIE regime, participation exemption is applicable to foreign-sourced dividends and disposal gains in relation to shares

or equity interests. It will not apply to disposal gains for other assets under the proposed refined regime.

- In line with the existing regime, disposal loss in relation to the proposed added assets can only be used to set off against FSIE income.
- Other features of the existing FSIE regime, including covered taxpayer, covered income, excluded income, economic substance requirement, adequacy test, nexus approach and double tax relief, etc. would remain unchanged.
- The Commissioner's Opinion or advance ruling on economic substance requirement previously granted will remain applicable provided that the relevant assets are disclosed in the applications.

### Comparison of existing and proposed FSIE regime in relation to disposal gain

	Existing regime	Proposed regime
<b>Covered taxpayer</b>	Multinational enterprise entities	Same
<b>Covered income and assets</b>	Disposal gains in relation to shares or equity interests	Disposal gains in relation to: <ul style="list-style-type: none"><li>• Shares or equity interests</li><li>• Debt instruments</li><li>• Movable properties</li><li>• Immovable properties</li><li>• IP</li><li>• Foreign currencies</li></ul>
<b>Excluded income</b>	Certain disposal gains derived by regulated financial entities and taxpayers benefitting from existing preferential tax regimes	Same
<b>Economic substance requirement</b>	Specified economic activities in HK and adequacy test	Same (for non-IP assets)
<b>Nexus approach</b>	N/A	Applicable to disposal gains on IP assets
<b>Participation exemption</b>	Applicable if certain conditions are met	Not applicable to assets other than share or equity interests

Other exemption or relief	N/A	<ul style="list-style-type: none"> <li>• Disposal gains for traders</li> <li>• Intra-group transfer relief</li> </ul>
Treatment of disposal loss	For setting off specified foreign-sourced income only	Same
Double tax relief	Bilateral and unilateral tax credit (HK resident) or deduction (non-HK resident)	Same

### Effective date

The refined FSIE regime will become effective from 1 January 2024.

### What's next

The Hong Kong Government is seeking comments from the relevant stakeholders on the proposed refined regime and will take into account the views and suggestions collected in negotiating with the EU and drafting the amendment bill. The plan is to introduce the amendment bill for reading in the Legislative Council in October 2023.

### Our observations

The above proposals are initially formulated by the Hong Kong Government and are subject to discussion and agreement with the EU. Certain issues may need to be further clarified and refined before proposing to the EU.

Taxpayers should watch out the development and seek professional advice in assessing the impact of the proposed refined FSIE regime.

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If you have any questions, please contact our professionals:

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