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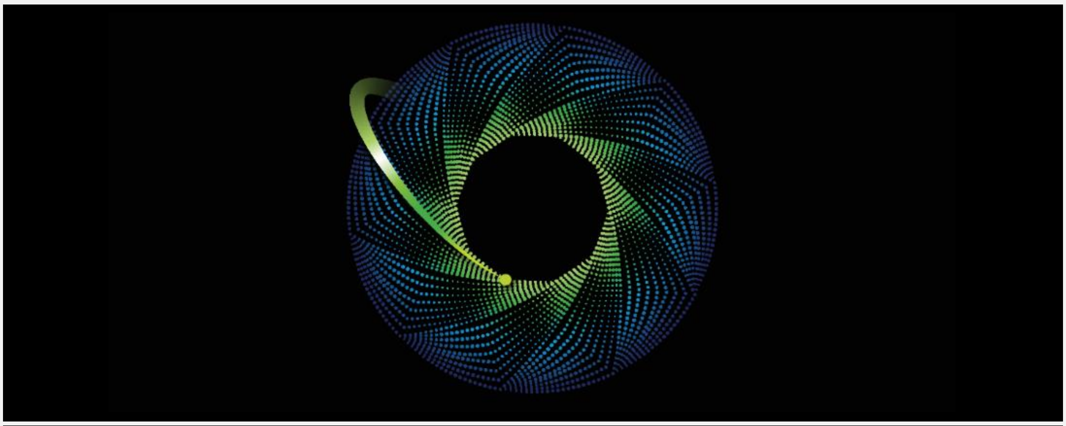

Hong Kong Tax Newsflash
Updates on refinements to Foreign-sourced Income Exemption (FSIE) regime for disposal gains

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The proposed refinements to FSIE regime for foreign-sourced disposal gains has been slightly updated further to the Hong Kong SAR government's negotiations with the European Union (EU) based on the views and suggestions collected during the consultation exercise conducted in April 2023.

In this article, we highlight the key updates and the proposed refinements to the FSIE regime for disposal gains. For background and details of the proposed refinements, please refer to our *Hong Kong Tax Newsflash Issue 177*.

Proposed refinements to FSIE regime

Covered assets

The EU did not accept Hong Kong's proposal to adopt a definite and exhaustive list of covered assets. It insisted that a non-exhaustive list of assets would need to be incorporated to cover all disposal gains, regardless of whether the assets are financial or non-financial in nature, according to the EU's updated FSIE guidance.

Computation of disposal gains or losses

The EU did not accept all the proposals on computation of disposal gains or losses, including rebasing approach on the cost of assets, taper relief based on the holding period and reduced tax rate for pre-commencement gains, as the EU considered that such measures without the need to comply with economic substance requirement are not in line with the purpose of the FSIE reform. In other words, there will be no relief in relation to the computation of disposal gains or losses.

Exemption and relief measures

The existing exemption requirements, i.e. economic substance requirement for non-intellectual property (IP) assets, nexus requirement for IP assets and participation requirement for equity interest will remain applicable. Exemptions for regulated financial entities and taxpayers benefiting from preferential regimes will also remain available.

In addition to the above exemptions, the following exemption or relief measures proposed in the consultation paper have been preliminarily agreed by the EU, subject to the EU's formal agreement.

- Carve-out for disposal gains of traders

  The IRD defined a trader as a person who sells, or offers to sell, property in its ordinary course of trade. The IRD will provide further guidance on the requirements for the carve-out, particularly the local business activities requirement, if any.

- Intra-group transfer deferral

  Tax on disposal gains could be deferred if the asset is transferred between associated companies. In considering whether the companies are associated, ownership threshold of 75% equity interest would be applied.

  The transferor (e.g. Company A) will be deemed to sell the asset at a consideration that secures a no gain / no loss position and the transferee (e.g. Company B) will be deemed to acquire the asset at the same cost and on the same date of acquisition as the transferor. When the asset is subsequently sold to a non-associated company, the disposal gain derived by Company B will be subject to the FSIE regime and Company B’s status (e.g. economic substance for disposal of non-IP asset) will be considered.

  The intra-group transferor and transferee are required to fulfil the following conditions:

  - Both the transferor and the transferee are within the charge to profits tax in Hong Kong for 6 years after the transfer; and

  - The transferor and transferee remain associated for 2 years after the transfer.

  Such relief will be revoked if the above conditions are not satisfied.

Implementation timetable

The government is in the process of drafting the amendment bill. It is expected that the amendment bill will be introduced into the Legislative Council for reading in October 2023. Upon enactment of the amendment bill, the proposed refinements will become effective on 1 January 2024.

Our comments

We appreciate that the government's effort in negotiating with the EU on the proposed refinements, especially the exemption and relief measures, with a view to upholding the tax competitiveness of Hong Kong.

The above proposed refinements are subject to the release of the draft legislation and the EU's final agreement. We look forward to the details of the proposed intra-group transfer deferral and the carve-out for traders when the draft legislation is released. Taxpayers should keep a close watch on the development and seek professional advice in assessing the impact of the proposed refined FSIE regime.

If you have any questions, please contact our professionals:

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