# HONG KONG TAX

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## BILL TO EXPAND SCOPE OF TAXATION OF FOREIGN-SOURCED DISPOSAL GAINS GAZETTED

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Draft legislation expanding the scope of foreign-sourced income exemption (FSIE) regime to cover disposal gains from disposal of all types of assets, ie Inland Revenue (Amendment) (Taxation on Foreign-sourced Disposal Gains) Bill 2023 (the Bill), was gazetted on 13 October 2023. The proposed change is in response to the European Union's updated FSIE guidance.

Once enacted, the refined regime will be effective from 1 January 2024. We highlight below the proposed changes and further details of the amendments to the FSIE regime.

### The expanded regime

The Bill expands the scope of disposal gains to include disposal of all types of assets (both moveable property and immovable property). Disposal gains arise from transfer of the property for valuable consideration. Under the proposed refined FSIE regime, specified foreign-sourced income derived by a covered taxpayer[1] will be deemed taxable when received in Hong Kong[2] unless one of the exceptions applies:

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[1] Covered taxpayer means an entity of a multinational enterprise group carrying on a trade, profession, or business in Hong Kong.

[2] Covered income is regarded as received in Hong Kong when:

- the income is remitted to, or is transmitted or brought into, Hong Kong;
- the income is used to satisfy any debt incurred in respect of a trade, profession or business carried on in Hong Kong; or
- the income is used to buy movable property, and the property is brought into Hong Kong. The income is regarded as being received at the time when the moveable property is brought into Hong Kong.

| Type of foreign-sourced income | Exception requirement |
|---|---|
| Dividends and disposal gains on equity interest | Economic substance requirement; or Participation requirement |
| Interest income | Economic substance requirement |
| Intellectual property (IP) income, including IP disposal gains (ie gains from disposal of IP assets) | Nexus requirement |
| Disposal gains from disposal of other assets **[NEW]** | Economic substance requirement |

Please refer to our tax news issued in November 2022 for details of the exception requirements.

## New exclusion and relief

The Bill contains the following new features:

1. **Non-IP disposal gains derived by traders excluded**

   To acknowledge foreign-sourced active income is not covered by the FSIE regime, foreign-sourced non-IP disposal gains derived from, or incidental to a taxpayer's business as a trader, are excluded from the refined FSIE regime. Non-IP disposal gains refers to gains from disposal of non-IP assets and includes disposal gains on equity interest.

   A trader means any entity that sells, or offers to sell, property in the entity's ordinary course of business.

   Whether a disposal gain derived by traders is foreign-sourced and non-taxable will be determined by applying the Inland Revenue Ordinance (IRO) and the broad guiding principle to the transactions from which the gain is derived.

2. **Intra-group transfer relief for both IP and non-IP disposal gains introduced**

   Subject to anti-abuse rules mentioned below, any tax on foreign-sourced disposal gains within a group received in Hong Kong will be deferred if the following conditions are met at the time of sale:

- Both the selling entity and the acquiring entity are chargeable to Hong Kong profits tax; and
- The selling entity and the acquiring entity are associated with each other.

Two entities are associated with each other if:

- One entity has at least 75% of direct or indirect beneficial interest or voting rights in the other entity; or
- A third entity has at least 75% of direct or indirect beneficial interest or voting rights in each of the two entities.

Under the proposed intra-group transfer relief, the selling entity is deemed to have sold the asset for a consideration that gives rise to no gain or loss for tax purposes, and the acquiring entity is deemed to have acquired the asset at the same cost and on the same date as the selling entity. The acquiring entity is taken as stepping in the shoes of the selling entity for the purposes of deduction of expenses and capital allowances, claim for tax credit and compliance with the participation requirement or nexus requirement.

To prevent the abuse of the intra-group transfer relief, the relief will be revoked within two years after the subject sale in the event that:

(i) the selling entity or the acquiring entity ceases to be chargeable to profits tax under the IRO; or

(ii) the selling entity and the acquiring entity cease to be associated (per the definition above) with each other.

The disposal gain will then be subject to the FSIE regime as if such gain was received in Hong Kong by the selling entity in the year of assessment during which the event in (i) or (ii) occurred. Any profits tax chargeable would be chargeable in the name of and recoverable from either the selling entity or the acquiring entity.

## Commissioner's Opinion and Advance Ruling

As a transitional measure to provide tax certainty, taxpayers may apply for the Commissioner's Opinion on their compliance with the economic substance requirement in relation to disposal gains of the added assets before enactment of the Bill. If a taxpayer has previously obtained a favourable Commissioner's Opinion on its compliance with the economic substance requirement in respect of foreign-sourced interest, dividend and/or equity interest disposal gain, it can also apply to expand the scope of the opinion obtained to cover disposal gains from the added assets that will be accrued on or after 1 January 2024.

Upon the passage of the Bill and the coming into operation of the amendment ordinance, the above transitional measure will cease and advance ruling can be applied in respect of compliance with the economic substance requirement.

## Key takeaways

Taxpayers are recommended to assess the potential effects of the proposed expanded FSIE rules for their groups and, where applicable, apply for the Commissioner's Opinion/apply to expand the previously obtained Commissioner's Opinion before the amendment ordinance becomes effective, ie the application should be made on or before 31 December 2023.

BDO's tax and transfer pricing experts are available to assist. Please contact us to discuss.

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