

Hong Kong (SAR) Tax Alert

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The HKSAR Government consults on the inclusion of foreign-sourced asset disposal gains under the FSIE regime

Summary



The HKSAR Government has just launched a stakeholder consultation on its proposed amendments to the existing foreign-sourced income exemption (FSIE) regime in the Hong Kong SAR (Hong Kong) to include foreign-sourced gains from disposal of assets other than shares and equity interests.

In this tax alert, we summarise the key changes proposed by the government and the issues on which views are sought, and highlight a number of areas in which we are going to provide our suggestions for the government's consideration.

The existing FSIE regime in Hong Kong that became effective from 1 January 2023 covers interest, dividends, equity disposal gains and income from use of intellectual properties (IPs) only. As a result of the European Union (EU) updating its guidance on FSIE regimes in late 2022¹ and explicitly requiring such regimes to cover gains from disposal of all types of assets (disposal gains), Hong Kong has committed to updating its existing FSIE regime by the end of 2023 to cover foreign-sourced gains from disposal of assets (proposed added assets) other than shares and equity interests. The expanded FSIE regime is expected to **take effective from 1 January 2024**².

Key changes proposed and views sought

The HKSAR Government circulated a consultation document on 6 April 2023 to set out the proposed changes to the FSIE regime and seek views from stakeholders on various related issues. The document focuses on the expanded scope of assets in relation to foreign-sourced disposal gains. The proposed changes are subject to negotiations with the EU.

Other existing features of the FSIE regime such as MNE entities as the covered taxpayers, the excluded income approach for non-IP income, the economic substance (ES) requirement for non-IP income, the participation exemption for dividends and equity disposal gains, the nexus approach for IP income and the double tax relief available remain unchanged.

The key proposed changes and the issues raised for comments in the consultation document are summarised below.

Covered assets

- The EU requires all disposal gains to be covered, regardless of whether they are capital or revenue in nature and whether the assets are financial or non-financial in nature.
- Although the government has explored a positive listing approach covering the following additional types of assets: (1) debt instruments, (2) movable properties, (3) immovable properties, (4) IPs and (5) foreign currencies, the EU requires a non-exhaustive list instead of a definite and exhaustive list of covered assets.

[Views are sought on: (1) the definition of covered assets and (2) whether the above 5 types of assets (or any other assets) should be cited as examples of covered assets in the domestic legislation.]

¹ The updated EU guidance on FSIE regimes can be found in the Annex to the report in this [link](#).

² For more details, please refer to our [Hong Kong \(SAR\) Tax Alert, Issue 1, February 2023](#).

Computation of disposal gains or losses

- The government has taken up with the EU on the possibility of rebasing the costs of assets to those as at the effective date of the FSIE regime when computing the taxable amount of disposal gains so that the taxation of foreign-sourced disposal gains would not be applied retrospectively.
- However, the EU has concerns about the grandfathering effect of such rebasing approach and advised that such approach has not been accepted by the EU for other jurisdictions.
- The government will explore with the EU other means, such as taper relief³, to reduce the impact on businesses if the rebasing approach is ultimately not accepted by the EU.

[Views are sought on how disposal gains or losses should be computed.]

Exemption or relief specific to disposal gains

- The government proposes exploring with the EU the following relief measures:

Disposal gains from traders – foreign-sourced disposal gains derived by a trader of an asset in relation to the asset as part of its income derived from substantial activities in Hong Kong (e.g. gains from sale of immovable properties by property developers) are to be carved out from the expanded FSIE regime; and

Intra-group transfer relief – subject to certain anti-abuse measures, taxation of foreign-sourced disposal gains from transfer of assets between associated *companies* is to be deferred (i.e. no gain or loss arises upon the transfer for the transferor company and no step-up of the cost base of the asset transferred for the transferee company).

- The transferor company and the transferee company are considered “associated” if one is the beneficial owner of **75% or more** of the *issued share capital* of the other, or a third *company* is the beneficial owner of **75% or more** of the *issued share capital* of each of them.

[Views are sought on the exemption or relief measures to be provided under the expanded FSIE regime.]

Other issues on which views are sought

The government is also seeking comments on the following issues:

- Whether there are other issues related to the expanded FSIE regime that need to be clarified in the legislative amendments or administrative guidance; and
- Whether there is any material impact of the differential implementation timelines set by the EU – i.e. Hong Kong is required to amend its FSIE regime by the end of 2023 for implementation from 1 January 2024 whereas some other jurisdictions⁴ will be allowed to amend their FSIE regimes by 30 June 2024 for implementation from 1 July 2024.

Other related issues

The consultation document also clarifies the following issues:

- Foreign-sourced disposal gains related to non-IP assets will continue to be exempt from tax if the ES requirement is met;
- The nexus approach will be adopted in determining the extent to which foreign-sourced disposal gains related to IP assets are to be exempted;
- Foreign-sourced disposal losses can only be used to set off against specified foreign-sourced income under the FSIE regime;
- Taxpayers can apply for a Commissioner’s Opinion in respect of their compliance with the ES requirement for the foreign-sourced gains from disposal of the proposed added assets before the enactment of the expanded FSIE regime as a transitional measure, or an advance ruling after the enactment of the expanded regime; and
- Provided that the proposed added assets are disclosed in the taxpayer’s previous application for Commissioner’s Opinion or advance ruling on the compliance with the ES requirement, the opinion or ruling previously granted will remain applicable under the expanded FSIE regime.

³ Taper relief provides a mechanism by which the taxable amount of disposal gains is reduced according to how long the assets have been held for. The UK previously provided such relief for capital gains tax but has abolished it since 6 April 2008.

⁴ These jurisdictions are those which are not currently undergoing a reform of their FSIE regimes but would be required to do so as a result of the EU’s updated guidance on FSIE regimes to cover all types of disposal gains.

Implementation timeline

The two-month consultation period will end on 6 June 2023. The government plans to introduce a bill with the necessary legislative amendments into the Legislative Council in October this year, with a view to securing the passage of the bill by the end of 2023.

KPMG observations

Unlike the legislative exercise conducted in 2022 for introducing the FSIE regime, the government has taken a slightly different approach this time i.e. launching a consultation to seek views on a number of outstanding issues before it continues to negotiate with the EU.

We welcome this revised approach and will provide our comments / suggestions on a number of issues for the government's consideration, including (1) the types of assets to be excluded, (2) justifications for the proposed rebasing approach, (3) other measures for reducing the impact of the new taxation of foreign-sourced disposal gains on businesses and (4) better options other than using "issued share capital" to measure the degree of association for the purposes of the intra-group asset transfer relief in light of the recent dispute in the John Wiley case⁵.

⁵ Please refer to our previous Hong Kong (SAR) Tax Alert on the case in this [link](#) for more details.

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