CWK 中主環球

CWK GLOBAL SNAPSHOT

NEW DEVELOPMENTS ON FOREIGN-SOURCED INCOME EXEMPTION (FSIE) REGIME –

EXTENDED COVERAGE ON ASSET DISPOSAL GAINS, OTHER EXCLUSIONS AND RELIEFS KEY HIGHLIGHTS

Effective date: 1 January 2024

CWK Global | Tax Advisory

December 2023

EXPECTED EFFECTIVE DATE: 1 JANUARY 2024

A draft legislation that further refines Hong Kong's FSIE regime by expanding the scope of foreign-sourced disposal gains (the 2023 Amendment Bill) was gazetted on 13 October 2023. The 2023 Amendment Bill expands the definition of disposal gain to include gains or profits derived from the sale of any property.

WHAT HAS HAPPENED IN 2023

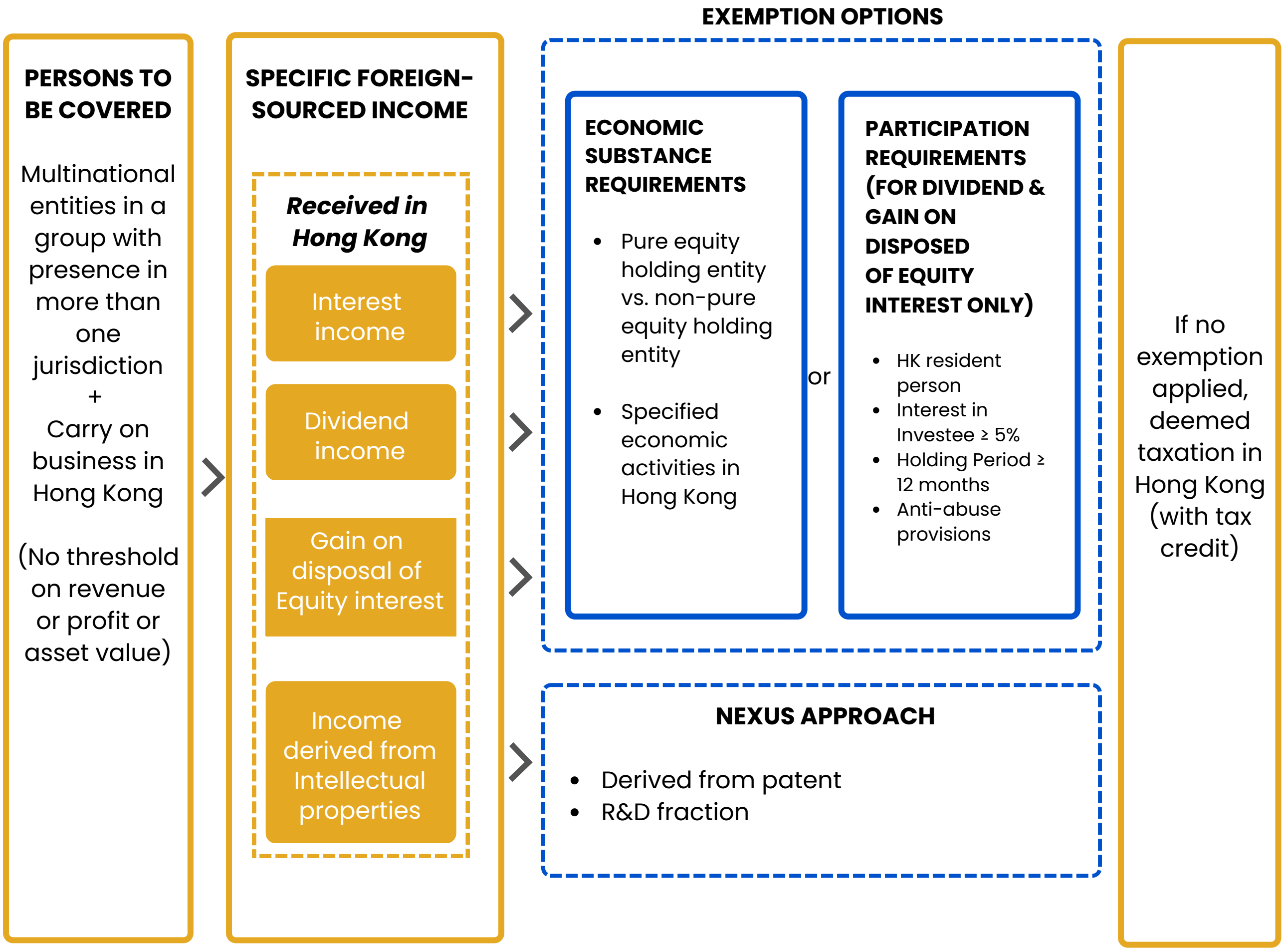
In order to align with international efforts to combat cross-border tax evasion and prevent double non-taxation, Hong Kong has implemented changes to its Foreign Source Income Exemption (FSIE) regime for passive income. The relevant Ordinance became effective on 1 January 2023.

INITIAL SCOPE COVERED SINCE 1 JANUARY 2023

The scope of specified foreign-sourced income within the FSIE initially includes the following types of income arising in or derived from a territory outside Hong Kong:

- Interest income
- Dividend income
- Disposal gains from the sale of equity interests in an entity
- Intellectual property (IP) income

As a recap diagram of initial refinement to FSIE on 1 January 2023:



+852 2548 8288
info@cwkglobal.com
21/F, Cosco Tower, No. 183 Queen's Road Central, Hong Kong

WHAT WILL BE COMING IN 2024?

PROPOSED EXTENDED SCOPE COMMENCING FROM 1 JANUARY 2024

The 2023 Amendment Bill expands the definition of disposal gain to include gains or profits derived from the sale of any assets and property.

With the new amendments, the specific scope under FSIE will be:
- Interest income;
- Dividend income;
- Disposal gains from the sale of equity interests in an entity;
- Intellectual property (IP) income; and
- (**Newly added**) Gains or profits derived from the sales of any property.

The term "property" is defined to cover both movable and immovable property, including but not limited to, real estate property, equipment, loan and debenture, commodity, foreign currency, etc.

Overall, the covered scope of specified foreign-sourced income under the FSIE entails interest income, dividend income, disposal gains from the sale of equity interests, intellectual property income, and, following the 2023 Amendment Bill, includes gains or profits from the sales of any property.

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Notwithstanding the extended scope, the revised FSIE regime introduces new exclusions: (i) Exclusion in relation to Traders, and (ii) Intra-group Transfer Relief for Disposal Gain.

EXCLUSION IN RELATION TO TRADERS

The scope of specified foreign-sourced income excludes any non-IP disposal gain that is earned by an entity operating as a trader and is derived from or incidental to its trading activities. "Trader" refers to an entity engaged in the regular sale or offering to sell property as part of its ordinary course of business.

The IRD has provided an example of trader exclusion. For a securities trading business in Hong Kong maintained an office in Hong Kong and employed certain staff to manage a portfolio of securities in Hong Kong, it acquired and disposed of foreign shares through a foreign stock exchange at a gain. Such foreign-sourced disposal gain was derived from the MNE entity's business as a securities trader and would be excluded from the scope of specified foreign-sourced income.

INTRA-GROUP TRANSFER RELIEF FOR DISPOSAL GAIN

Intra-group transfer relief applies if the property and/or asset is transferred between associated entities. Entities would be considered as associated if one entity has at least 75% of direct or indirect beneficial interest or voting rights in the other, or a third party is associated with both entities.

Should the relief apply, the transfer was treated as if it acquired and sold the subject property at a consideration that results in neither a gain nor a loss.

However, the relief will be revoked if:

- Both entities selling and acquiring the property are required to be chargeable to profits tax in Hong Kong within 2 years after the transfer of the property; and

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- The entities selling and acquiring the property are required to remain associated within 2 years after the transfer of the property

TAKE ACTION NOW

Reach out to your tax expert on the assessment of the FSIE exposures on covered assets and evaluate the needs of application for the Commission's Opinion

In order to simplify compliance procedures and provide tax certainty, multinational enterprise (MNE) entities have the option to seek the Commissioner's opinion ("the Opinion") on their adherence to the economic substance requirement for disposal gains on the newly added assets under the 2023 Amendment Bill.

For an MNE entity that has already obtained a favorable Opinion/ advance ruling regarding its compliance with the economic substance requirement for foreign-sourced interest, dividend, and/or equity interest disposal gains, it can also apply to expand the scope of the existing Opinion to encompass disposal gains from the added assets that accrue to it on or after January 1, 2024.

Availability period of Commissioner's Opinion

Once the 2023 Amendment Bill is enacted and the amended ordinance takes effect (likely to be 1.1.2024), this transitional measure for applying and expanding the Opinion will be discontinued, MNE entities can instead apply for advance rulings on the application of the economic substance requirement.

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CWK OBSERVATIONS

One should note that the participation requirement is not applicable to the extended scope of disposal gain on other property under the 2023 Amendment Bill. It only applies to foreign-sourced dividend and equity interest disposal gains received in Hong Kong. As such, it is important to understand the necessary economic substance requirements.

Enterprises in Hong Kong should assess if they will be impacted by the refinement to the FSIE regime and evaluate the ways to mitigate potential impacts, for example:

- Whether the trader exclusion applies
- Whether the intra-group transfer exclusion applies
- Evaluate if the existing establishment in Hong Kong can satisfy the necessary economic substance requirement for FSIE
- Revisit business structure and business model for potential non-taxable onshore sourced capital gain claim under the upcoming tax certainty enhancement scheme for equity interest disposal gain (to be effective)

Enterprises should also assess if they should apply for a Commissioner's Opinion / advanced ruling on compliance with economic substance requirements for certainty.

+852 2548 8288 info@cwkglobal.com 21/F, Cosco Tower, No. 183 Queen's Road Central, Hong Kong

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+852 2548 8288 info@cwkglobal.com 21/F, Cosco Tower, No. 183 Queen's Road Central, Hong Kong

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+852 2548 8288 info@cwkglobal.com 21/F, Cosco Tower, No. 183 Queen's Road Central, Hong Kong

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CONTACT US
FOR MORE INFORMATION

EVY WONG

Principal Partner, Tax and Advisory
evy.wong@cwkglobal.com

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CWK Global

+852 2548 8288

info@cwkglobal.com

21/F, Cosco Tower, No. 183 Queen's Road Central, Hong Kong