

# Hong Kong Tax Alert

17 October 2023  
2023 Issue No. 12

## Bill for expanding the scope of foreign-sourced disposal gains now gazetted

Last Friday, on 13 October 2023, the legislative bill for the foreign-sourced income exemption (FSIE) regime<sup>1</sup> to extend the scope of disposal gains to cover all types of assets was gazetted.

This change to the Hong Kong FSIE regime is proposed to comply with the updated Guidance on FSIE regimes issued by the European Union (EU) in December 2022. Otherwise, Hong Kong could be blacklisted by the EU and subject to certain tax-related defensive measures to be adopted by EU member states, e.g., a higher withholding tax suffered in the jurisdictions concerned.

Most of the features of the proposal have been referred to by the government during its previous engagement sessions with the stakeholders. Please refer to our previous alert issued on 14 August 2023<sup>2</sup> for detailed discussion of these features.

---

### Notes:

(1) [The Government of the Hong Kong Special Administrative Region Gazette \(legco.gov.hk\)](https://legco.gov.hk)

(2) [Update on tax certainty for onshore disposal gains and refined foreign-sourced income exemption \(FSIE\) regime | EY](#)



## Intra-group transfer relief

### *Non-IP disposal gains (IP stands for intellectual property)*

Of significant note is that, as compared to that indicated in the previous engagement sessions, the condition for the proposed intra-group transfer relief for disposal gain is now changed such that the selling and the acquiring entities are required to be within the charge to profits tax in Hong Kong for two years instead of six years. The other conditions that require both the selling and the acquiring entities to be associated at the time of the transfer and that they remain associated for two years are the same as previously indicated.

If, within the two-year period, either (a) the selling entity or the acquiring entity is not within the charge to profits tax in Hong Kong; or (b) the selling entity and the acquiring entity cease to be associated, the intra-group transfer relief previously granted will be withdrawn. As a result, the disposal gain will be taxed in the year when either (a) or (b) occurs.

Such a tax assessment can be issued either in the name of the selling entity or the acquiring entity and the tax involved is recoverable by all means as provided in the Inland Revenue Ordinance (IRO) from the selling entity or the acquiring entity.

### *IP disposal gains*

Where an intra-group transfer relief has been granted for an IP disposal gain and the acquiring entity subsequently sells the acquired IP asset, the extent of the subsequent disposal gain that is offshore sourced and will be exempted from taxation under the proposed amended FSIE regime will also be determined by the nexus ratio<sup>3</sup>.

In this regard, the bill provides that the qualifying R&D expenditures and non-qualifying expenditures incurred by the selling entity on the related IP assets will be deemed to have been incurred by the acquiring entity. In other words, such expenditures incurred by the selling entity will be included as qualifying and non-qualifying expenditures of the acquiring entity when calculating its nexus ratio.

---

#### Notes

(3) Refers to the R&D fraction defined in section 4 of schedule 17FC of the IRO:

$$F = QE \times 130\% / (QE + NE)$$

where:

F means the R&D fraction;

QE means the qualifying R&D expenditure incurred in respect of the qualifying intellectual property to which the qualifying IP income relates (subject intellectual property); and

NE means the non-qualifying expenditure incurred in respect of the subject intellectual property.



## Major features of the proposed amended FSIE regime

The below table lists out the major features of the proposed amended FSIE regime:

Features	Relevant provisions contained in the bill
<b>1. Covered assets</b>	<ul style="list-style-type: none"><li>• A non-exhaustive list of assets will be incorporated.</li><li>• Under the bill, any IP disposal gain or non-IP disposal gain will be covered assets. Non-IP disposal gain means any gain or profit derived from the sale of property but does not include IP disposal gain. Property means any movable property or immovable property.</li></ul>
<b>2. Exclusions and relief</b>	<ul style="list-style-type: none"><li>• Exclusion of relevant disposal gains from the scope of the proposed amended FSIE regime for regulated financial entities and taxpayers benefitting from preferential regimes will be available.</li><li>• Exclusion of disposal gains that are derived from, or incidental to, the business of traders will also be available.<ul style="list-style-type: none"><li>• Trader: An entity that sells, or offers to sell, property in the entity's ordinary course of business</li><li>• While a trader may be carrying on business in Hong Kong, the substantial business activities that generated the disposal gains may still be conducted outside Hong Kong. As such, the offshore claims in Hong Kong for the disposal gains would not be undermined and remain non-taxable under section 14 of the IRO. At the same time, such disposal gains will not fall within the scope of the proposed amended FSIE regime</li></ul></li><li>• Intra-group transfer relief is available under which any tax charged on IP and non-IP disposal gains can be deferred if the asset concerned is transferred between associated entities, and subject to the below conditions and anti-abuse rules:<ul style="list-style-type: none"><li>• Both the selling and acquiring entities are chargeable to profits tax in Hong Kong at the time of the subject sale</li><li>• Meet the 75% association threshold which is determined with reference to direct or indirect beneficial interests in, or voting rights in the investee entity.</li><li>• Remain associated for two years after the transfer</li><li>• Both the selling and acquiring entities are within the charge to profits tax in Hong Kong for two years after the transfer</li><li>• Selling entity: Deemed to sell the property at a consideration that secures a no gain / no loss position</li><li>• Acquiring entity: Deemed to acquire the property at the same cost and same date as the selling entity</li></ul></li></ul>
<b>3. Implementation timetable</b>	<ul style="list-style-type: none"><li>• The bill is expected to be enacted into law effective from 1 January 2024 to comply with the EU's requirement.</li></ul>

### Our observations

We welcome the government taking onboard many of the comments made by stakeholders during the various engagement sessions. In particular, the government has accepted our suggestion of carving out the disposal gains of traders from the scope of the proposed amended FSIE regime without requiring that the trader to have substantial business activities in Hong Kong, otherwise that would significantly undermine the offshore claims for such gains.

However, the requirement that the selling entity and the acquiring entity must be within the charge to profits tax in Hong Kong within two years for the intra-group transfer relief may hinder certain group restructuring arrangements whereby the selling entity would need to be liquidated shortly after the transfer.

Clients who have any comments or views on the bill can contact their tax executives and we will convey the same in an appropriate manner to the Bills Committee of the Legislative Council that scrutinizes the bill.

## Hong Kong office

Jasmine Lee, Managing Partner, Hong Kong & Macau  
27/F One Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong  
Tel: +852 2846 9888 Fax: +852 2868 4432

Non-financial Services				Financial Services	
Wilson Cheng Tax Leader for Hong Kong and Macau +852 2846 9066 wilson.cheng@hk.ey.com				Paul Ho Tax Leader for Hong Kong +852 2849 9564 paul.ho@hk.ey.com	
Business Tax Services / Global Compliance and Reporting				Business Tax Services / Global Compliance and Reporting	
Hong Kong Tax Services				Hong Kong Tax Services	
Wilson Cheng +852 2846 9066 wilson.cheng@hk.ey.com		Tracy Ho +852 2846 9065 tracy.ho@hk.ey.com		Paul Ho +852 2849 9564 paul.ho@hk.ey.com	
May Leung +852 2629 3089 may.leung@hk.ey.com		Ada Ma +852 2849 9391 ada.ma@hk.ey.com		Ming Lam +852 2849 9265 ming.lam@hk.ey.com	
Grace Tang +852 2846 9889 grace.tang@hk.ey.com		Karina Wong +852 2849 9175 karina.wong@hk.ey.com		Sunny Liu +852 2846 9883 sunny.liu@hk.ey.com	
Jacqueline Chow +852 2629 3122 jacqueline.chow@hk.ey.com		Leo Wong +852 2849 9165 leo.wong@hk.ey.com		Helen Mok +852 2849 9279 helen.mok@hk.ey.com	
China Tax Services				Customer Tax Operations and Reporting Services	
Ivan Chan +852 2629 3828 ivan.chan@hk.ey.com		Sam Fan +852 2849 9278 sam.fan@hk.ey.com		Paul Ho +852 2849 9564 paul.ho@hk.ey.com	
Carol Liu +852 2629 3788 carol.liu@hk.ey.com		Becky Lai +852 2629 3188 becky.lai@hk.ey.com		US Tax Services	
Payroll Operate		Accounting Compliance and Reporting		Camelia Ho +852 2849 9150 camelia.ho@hk.ey.com	
Vincent Hu +852 3752 4885 vincent-wh.hu@hk.ey.com		Linda Liu +86 21 2228 2801 linda-sy.liu@cn.ey.com		Michael Stenske +852 2629 3058 michael.stenske@hk.ey.com	
Cecilia Feng +852 2846 9735 cecilia.feng@hk.ey.com				International Tax and Transaction Services	
International Tax and Transaction Services				China Tax Services	
International Tax Services		Transfer Pricing Services		Cindy Li +852 2629 3608 cindy.jy.li@hk.ey.com	
Jo An Yee +852 2846 9710 jo-an.yee@hk.ey.com		Sangeeth Aiyappa +852 2629 3989 sangeeth.aiyappa@hk.ey.com		International Tax Services	
		Martin Richter +852 2629 3938 martin.richter@hk.ey.com		Sophie Lindsay +852 3189 4589 sophie.lindsay@hk.ey.com	
		Kenny Wei +852 2629 3941 kenny.wei@hk.ey.com		Stuart Cioccarelli +852 2675 2896 stuart.cioccarelli@hk.ey.com	
Transaction Tax Services				Rohit Narula +852 2629 3549 rohit.narula@hk.ey.com	
David Chan +852 2629 3228 david.chan@hk.ey.com		Jane Hui +852 2629 3836 jane.hui@hk.ey.com		Adam Williams +852 2849 9589 adam-b.williams@hk.ey.com	
Eric Lam +852 2846 9946 eric-yh.lam@hk.ey.com		Qiannan Lu +852 2675 2922 qiannan.lu@hk.ey.com		Maggie To +852 3752 4779 maggie.to@hk.ey.com	
People Advisory Services				Ruairi Lamb +852 2846 9070 ruairi.lamb@hk.ey.com	
Robin Choi +852 2629 3813 robin.choi@hk.ey.com		Mary Chua +852 2849 9448 mary.chua@hk.ey.com		Transfer Pricing Services	
Christina Li +852 2629 3664 christina.li@hk.ey.com		Jeff Tang +852 2515 4168 jeff.tk.tang@hk.ey.com		Ka Lok Chu +852 2629 3044 kalok.chu@hk.ey.com	
Winnie Walker +852 2629 3693 winnie.walker@hk.ey.com		Paul Wen +852 2629 3876 paul.wen@hk.ey.com		Justin Kyte +852 2629 3880 justin.kyte@hk.ey.com	
Asia-Pacific Tax Centre					
Tax Technology and Transformation Services		International Tax and Transaction Services		Indirect tax	
Agnes Fok +852 2629 3709 agnes.fok@hk.ey.com		US Tax Desk		Shubhendu Misra +852 2232 6578 shubhendu.misra@hk.ey.com	
Robert Hardesty +852 2629 3291 robert.hardesty@hk.ey.com		Jeremy Litton +852 3471 2783 jeremy.litton@hk.ey.com		Andy Winthrop +852 2629 3556 andy.p.winthrop@hk.ey.com	
Albert Lee +852 2629 3318 albert.lee@hk.ey.com		Peggy Lok +852 2629 3866 peggy.lok@hk.ey.com			
		Winona Zhao +852 2515 4148 winona.zhao1@hk.ey.com			
		Operating Model Effectiveness		Tax and Finance Operate	
		Alice Chung +852 3758 5902 alice.chung@hk.ey.com		Tracey Kuuskoski +852 2675 2842 tracey.kuuskoski@hk.ey.com	
		Edvard Rinck +852 9736 3038 edvard.rinck@hk.ey.com			

## EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients, nor does it own or control any member firm or act as the headquarters of any member firm. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via [ey.com/privacy](https://ey.com/privacy). EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit [ey.com](https://ey.com).

### About EY's Tax services

Your business will only succeed if you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our 50,000 talented tax professionals, in more than 150 countries, give you technical knowledge, business experience, consistency and an unwavering commitment to quality service – wherever you are and whatever tax services you need.

© 2023 Ernst & Young Tax Services Limited.  
All Rights Reserved.  
APAC no. 03018572 ED None.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

[ey.com/china](https://ey.com/china)



**Follow us on WeChat**  
Scan the QR code and stay up-to-date with the latest EY news.