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The Treasury Branch
Financial Services and the Treasury Bureau
24/F, West Wing, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

By Email: fsie@fstb.gov.hk

Dear Sir/Madam,

CPA Australia's response to refinements to Hong Kong's foreign-sourced income exemption regime for foreign-sourced disposal gains

As one of the largest professional accounting bodies in the world, CPA Australia represents the diverse interests of over 173,000 members working in 100 jurisdictions and regions around the world. This includes over 15,000 members in Hong Kong. We make this submission on behalf of our members and in the broader public interest.

CPA Australia welcomes the proposed "Refinements to Hong Kong's foreign-sourced income exemption regime for foreign-sourced disposal gains". We provide the following comments and suggestions to the five questions posed in the consultation paper below.

Do you have any views on the definition of covered assets and whether or not the five kinds of assets listed or any other additional types of assets should be cited as examples in the legislation if the non-exhaustive approach in defining covered assets is to be adopted?

Prima facie, our view is that the Hong Kong Government (the Government) should seek to confine the regime to no more than the five covered assets listed in paragraph 12 of its consultation paper. While we recognise the need for the Government to align with the European Union (the EU)'s refined foreign-sourced income exemption (FSIE) regime, our fundamental premise is to limit the asset classes being covered by the refined FSIE regime to provide investor certainty and maintain Hong Kong's tax competitiveness while still properly addressing the issues raised by the EU.

Furthermore, given the focus of the FSIE regime is to overcome the double non-taxation of foreign-sourced asset disposal gains, we question the need to include paragraph 12, item (c) – immovable properties as a covered asset, as disposals of immovable properties should already be taxed in the local jurisdictions. For example, foreign residents will be taxed in Australia for their disposal of taxable Australian real property under **Division 855 of the *Income Tax Assessment Act 1997***.

Clarity from the Government or the Inland Revenue Department (IRD) will be required for the definition and examples for each of the five covered asset categories, so multinational enterprises (MNEs) can determine the scope and range of assets subject to the refined FSIE regime. For example, in relation to paragraph 12, item (a) debt instruments, we seek clarification from the Government or the IRD on whether the definition of this covered asset includes intercompany loans, and where these loans do not have formal written agreements. We request further details on such issues before we can support the inclusion of these three types of assets as covered assets.

If the EU's non-exhaustive approach in defining covered assets is to be adopted instead, our position is that the five kinds of assets listed, or any other additional types of assets should not be cited as examples in the legislation. Their quotation as examples in the legislation is misleading and confusing, when the FSIE regime under the EU's non-exhaustive approach is not restricted to these five types of covered assets. It also does not provide any clarity or benefits, when all foreign-sourced asset disposal gains fall within the scope of the refined FSIE regime.

Do you have any views on how disposal gains or losses should be computed?

Should the grandfathering or the taper relief proposed by the Hong Kong Government be accepted by the EU, our position is that existing assets subjected to the refined FSIE regime should be grandfathered or tapered until when Hong Kong implements the proposed refined FSIE regime, i.e., when the refined FSIE legislation is passed by the Legislative Council and take effect after it is signed and promulgated by the Chief Executive.

The EU only requires Hong Kong to amend its FSIE regime by the end of 2023 and implement it from 1 January 2024. Therefore, we consider the determination and setting of the Hong Kong corporate tax rate in relation to the foreign-sourced asset disposal gains is not necessary to be contemplated by the EU. Instead, the Government should focus on Hong Kong's tax environment remaining competitive when implementing the EU's expanded FSIE requirements when setting Hong Kong's corporate tax rate for foreign-sourced asset disposal gains.

As an example, Singapore has **implemented** FSIE reforms since 1 June 2003, therefore the EU will now assess its FSIE status separately. As such, we understand Singapore is not under the EU's refined FSIE implementation timeline, unlike Hong Kong, which has an implementation date of 1 January 2024. Furthermore, Singapore does not **impose** a corporate tax on sales of shares, properties, and other intangible assets in Singapore, unless the **primary purpose** in buying and selling is to make profits.

Given the differential FSIE implementation timelines among international jurisdictions including Singapore (see below), in order to maintain Hong Kong's tax competitiveness, we propose that the tax rate for FSIE foreign-sourced asset disposal gains be at no more than half of the existing Hong Kong corporate tax rate, i.e., 8.25 per cent and preferably lower, at least for the initial stages of the refined FSIE regime implementation, until a more level playing field is established for the FSIE regime among all participating jurisdictions in the future.

Do you have any views on the exemption or relief measures to be provided under the refined FSIE regime to ease the compliance burden of covered taxpayers?

Disposal gains from traders

In relation to the proposed carve-out for disposal gains from traders, given the refined FSIE's focus is on passive income, our position is that the carve-out should be available regardless of whether substantial business activities are conducted in Hong Kong or not. To impose 'the substantial activities in Hong Kong' as a condition for traders is meaningless, because if multinational enterprises (MNEs) have substantial activities in Hong Kong, they are unlikely to have foreign-sourced asset disposal gains, regardless of whether it is inventory or office equipment, being active income from the carrying on of a trading business.

Furthermore, we seek to better understand how the satisfaction of the economic substance requirement for disposal gains on covered assets would not undermine the offshore claims for such trading profits. Further examples from the Government or the IRD would be helpful in this regard.

Intra-group transfer relief

In relation to the proposed intra-group transfer tax deferral relief between associated companies, in view of the recent ***John Wiley's Case***, we suggest that the Government should reconsider its position on using issued share capital in determining 75 per cent ownership interest. Instead, the 75 per cent intragroup relief should include beneficial interest because it is common to have different entities within a MNE group including partnerships, trusts, and limited liability companies or partnerships. Therefore, our position is to not use the term issued share capital, and this is supported by case law.

Furthermore, for tax deferral of disposal gains on covered assets for intragroup transfers, we propose the Government consider whether the threshold can be reduced to below 75 percent. That is, provided the covered assets stay within an MNE group, and the assets are consolidated in the group accounts on a line-by-line basis, then regardless of the extent of the minority interests in the transferor and the transferee, the proposed intra-group relief should still apply. Our position is to reduce from 75 percent to 50 percent in line with the **two-tiered profits tax rates** regime. This is also in alignment with the MNE consolidated group position under Pillar 2 of BEPS 2.0.

Do you have any suggestions on issues related to the parameters of the refined regime that need to be clarified in the contemplated legislative amendments or administrative guidance and any parameters not covered in this paper?

Given the above, even after the refined FSIE legislation is enacted, we anticipate that there will be significant administrative guidance and legislative refinements required to assist taxpayers in their implementation of the expanded FSIE regime.

Before the refined FSIE bill is released for public consultation, we request the Commissioner of Inland Revenue to provide his opinion where taxpayers are in doubt on any transaction that may be subject to the expanded scope under the refined FSIE regime, i.e., the same process that was in place when the FSIE reform was first introduced in Hong Kong last year.

Do you have any views on the material impact of the EU's differential implementation timelines?

Given Hong Kong has actively complied with the FSIE reforms, we recommend that Hong Kong's FSIE regime be amended by the end of 2023, and to include a concession to have an implementation date of 1 January 2025 instead of 1 January 2024. The reason is the pace of FSIE reforms to date implemented by the Government since last year has already caused significant uncertainties and stress to MNEs operating in Hong Kong. This has an adverse impact on the Hong Kong economy, with some MNEs having chosen to exit Hong Kong permanently for more stable tax jurisdictions.

Furthermore, as discussed above, Singapore has **implemented** FSIE reforms since 1 June 2003, therefore the EU will assess its FSIE status separately. As such, we understand Singapore is not required to be under the EU's refined FSIE implementation timeline, unlike Hong Kong, which is inequitable.

Due to the preparation for the pending implementation of BEPS 2.0 by MNEs internationally, there has been significant administrative burden already for these taxpayers operating in Hong Kong. Meanwhile, these MNEs also have to prepare for further FSIE reforms and without clear administrative guidance. At present, both taxpayers and their advisors are struggling to embrace these different tax changes happening at the same time in Hong Kong. It is a significant amount of work for MNEs and their advisors to just work out what the various impacts are on their company groups in Hong Kong.

Therefore, we submit to the Government that MNEs should not have to implement FSIE legislation imposed by the EU on such a short notice. It is not only a matter of whether the government can enact the refined FSIE rules within the tight time of 1 January 2024, but also a matter of allowing sufficient time for the taxpayers and their advisors in Hong Kong to digest the new law and to react and adapt to these further FSIE reforms. Extending the implementation date by twelve months is not unreasonable given the current uncertainty and lack of details around the potential reforms, let alone having all of the expanded FSIE regime details about groupings, intragroup relief, carve-outs or taper reliefs being identified or settled, meanwhile the Government is still in the midst of its FSIE negotiation process with the EU. Therefore, it would not be in Hong Kong's best interest to rush the legislative amendments and implement the expanded FSIE regime on 1 January 2024.

If Hong Kong cannot secure an implementation date of 1 January 2025, then our position is that the Hong Kong Government should seek to implement the refined FSIE changes on 1 July 2024, the same date as the other non-compliant jurisdictions which are yet to implement their FSIE regimes but are required to. If these non-compliant jurisdictions are given an extension of time to implement their FSIE regimes, we submit that Hong Kong should also receive the same.

If you would like to discuss this submission, please contact Jonathan Ng, Policy Adviser at jonathan.ng@cpaaustralia.com.au.

Yours sincerely,

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Vice Chair International

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Interim Chief Learning and Innovation Officer

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