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R1 Division, Treasury Branch
Financial Services and the Treasury Bureau
24/F, West Wing, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

By Email: ogdei@fstb.gov.hk

Dear Sir/Madam,

CPA Australia's response to enhancing tax certainty of onshore gains on disposal of equity interest

As one of the largest professional accounting bodies in the world, CPA Australia represents the diverse interests of over 172,000 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 "Tax certainty enhancement scheme" which will provide greater certainty of non-taxation of onshore gains from the disposal of equity interests in Hong Kong. We offer the following comments and suggestions below.

Basic conditions for non-taxation

Under the proposed scheme, onshore equity disposal gains derived by an investor entity would be regarded as non-taxable, without the need to conduct the "badges of trade" analysis if the following condition is satisfied:

> *"The investor entity has held **at least 15 per cent** of the total equity interest in the investee entity for a continuous period of at least 24 months ending on the date immediately prior to the date of disposal of such interest". (Emphasis added)*

Lowering the shareholding percentage requirement to 10 per cent

We suggest that the Government considers lowering the shareholding percentage requirement for the onshore disposal gain safe harbour from 15 per cent to 10 per cent.

Such an approach would also align with the proposed treatment of "Excluded Equity Gain or Loss" provided in the Global Anti-Base Erosion (GloBE) Model Rules of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. For GloBE purposes, gains on disposal of equity interests in an entity would be excluded from GloBE income if, at the time during the transfer, the relevant multinational enterprise (MNE) group holds 10 per cent or more of the equity interests in the entity. Our view is based on the 'portfolio shareholding' definition under Article 10.1 of the Model Rules and the discussion at Section 2.2.1 of the OECD Administrative Guidance on the GloBE Model Rules.

The Government may wish to consider further lowering the percentage to 5 per cent.

A number of European Union (EU) countries, for example the Netherlands, provides a capital gain tax exemption for non-portfolio investments under their participation exemption regimes if a minimum of 5 per cent of the shares is held and other conditions are also satisfied. Furthermore, we note that Hong Kong's participation exemption under foreign-sourced income exemption (FSIE) is also 5 per cent.

Inclusion of beneficial ownership interests

We propose that the Government considers the inclusion of beneficial ownership interests to satisfy the basic conditions of the 15 per cent investee entity ownership requirement for group holding companies. An option would be to adopt the existing beneficial ownership test under the double tax agreements in determining direct and indirect ownership interests for group holding companies.

The reason is, that for this type of arrangement at a group company level, the ultimate holding company may use a number of different vehicles or companies to hold the same type of shares in an investee entity. In these cases, some of these investor entities may have direct and indirect shareholdings of less than 10 per cent, but when they are added together, their effective shareholdings in the investee entity would be higher than 15 per cent. Therefore, we propose the inclusion of beneficial ownership interest to satisfy the 15 per cent equity interest, so group companies can trace minority shareholdings and include their ultimate beneficial owner.

Intragroup transfer relief

We identify the following opportunities to expand the onshore equity disposal gains exemption and to provide relief for company groups. Such relief will provide company groups with the flexibility to move equity across associated companies while retaining the benefits of the exemption.

Tax treatment for intragroup transfers

We propose that for the onshore equity disposal gains exemption, if the transferor and transferee are within the same group (i.e., intragroup transfer), that the Government could consider a preferential tax treatment. For example, to satisfy the exemption for intragroup transfers, the approach could consider the holding period of the entire group of companies rather than solely that of the transferor, which obviates the need for each company within the group being required to satisfy a continuous holding period of at least 24 months.

Example:
Companies A, B and C are within the same company group. Company A owns the equity interests for 20 months and then transfers the ownership to Company B. Company B then owns the equity interest for four months and transfers to Company C. When we look at the tax position of Company B, our recommended approach would look at the holding period of the entire group of companies rather than just Company B. However, we note that the preferential treatment would only apply to intra group transfer.

Ownership percentage and beneficial interests across a group

With intragroup transfers, we propose that the Government also considers looking at the ownership percentage or beneficial interest held by fellow subsidiaries in the same company group.

Example:
Companies A and B are ultimately owned by the same parent company. Company A owns 10 per cent of the underlying equity of Company C, and Company B owns 5 per cent of Company C. Based on the current proposal, Company B would not be able to access the tax exemption. However, in relation to intragroup transfers, if the Government considers the availability of the tax exemption to take into account Company A's ownership interest of that third company, an exemption would be available to Company B.

Ownership percentage requirement for intragroup relief

We propose that, in order to avail themselves of the intragroup relief that we recommend, the transferor and transferee must have an at least a 90 per cent ownership requirement (that is, be owned at least 90 percent common ownership), similar to that of the stamp duty group relief. From a corporate group perspective, a threshold of 90 per cent would be consistent with the group relief threshold under the Stamp Duty Ordinance for associated body corporates.

Previous trading stock exclusion

We understand that the proposed onshore tax exemption excludes equity interests previously treated as trading stock for tax purposes in accordance with the "badges of trade" analysis. However, if there is a change of intention from holding the equity interests as trading to holding them as a long-term investment, the investor entity cannot rely on the scheme. It has to make a non-taxable claim for future disposal of the remaining equity interests based on the "badges of trade" principles.

We suggest that it might be beneficial to provide taxpayers with the opportunity to access the proposed tax exemption for onshore equity disposal gains by using both:

- their audited financial statements, and
- their company tax returns, by making the relevant declaration and disclosure under section 15BA of the Inland Revenue Ordinance to evidence their change of intention from holding equity as trading stock to holding it as an asset for long-term investment.

If there was such a change of intention with respect to holding equity interests and it was deemed taxable under s15BA, it should not be excluded from the enhancement scheme.

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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