EY 安永
Building a better working world

Hong Kong Tax Alert

19 April 2023
2023 Issue No. 3

Consultation paper issued on safe harbor rule for onshore gains on disposal of equity interests

The Treasury Branch of the Financial Services and the Treasury Bureau (FSTB) issued a consultation paper late last month on "Enhancing Tax Certainty of Onshore Gains of Equity Interests" (the Paper) seeking the views of stakeholders on the proposals contained in the Paper.

Subject to the views collected in a two-month consultation period, the HKSAR Government (the government) will codify the proposals by way of amending the Inland Revenue Ordinance, the effective date of the proposed legislation being from 1 January 2024.

For this purpose, equity interests include ordinary shares, preference shares and partnership interests.

This alert explains the conditions for the safe harbor rule whereby onshore disposal gains on equity interests, while not subject to the foreign source income exemption (FSIE) regime effective from 1 January 2023, will be accepted as being non-taxable capital gains in Hong Kong.

Clients who have any questions on the above or thoughts on the proposed safe harbor rule can contact their tax executives and we will convey the same to the FSTB in an appropriate manner.

Proposed safe harbor rule

Subject to certain exceptions, an onshore gain on disposal of an equity interest will be deemed a non-taxable capital gain in Hong Kong if the equity interest is at least 15% of the total equity interest of an entity and is held continuously for 24 months before a disposal.

The proposed safe harbor rule will however not apply where the equity interest

(i) has previously been regarded as trading stock for tax purpose in accordance with the "badges of trade" analysis;

(ii) is held by an insurance business; or

(iii) is non-listed and is in respect of (a) an immovable property trading entity; or (b) an immovable property-rich entity, i.e., more than 50% of the entity's total assets are immovable properties by value; or (c) an entity that
1. is engaged in property development where the immovable property developed is not used by the investee entity to carry on its own trade or business to derive trade or business income (including letting); or
2. has undertaken any property development in the past 60 months before the disposal of the equity interest.

The above exceptions apply regardless of whether the immovable properties are located in Hong Kong or overseas. Of note is that exception (iii) above does not apply where the equity interest concerned is listed.

Where the conditions for the above safe harbor rule are not satisfied, the taxability of the disposal gains will fall back to be determined by the normal "badges of trade" analysis.

Commentary

Enhancing Hong Kong as a location for holding equity investments

We welcome the proposed safe harbor rule, the introduction of which is primarily driven by the enactment of the foreign-sourced income exemption (FSIE) regime in Hong Kong effective from 1 January 2023. Under the FSIE regime, unless the economic substance requirement or the conditions for the participation exemption are satisfied, foreign-sourced disposal gains on equity interests, regardless of whether they are capital or revenue in nature, received in Hong Kong by a multinational enterprise (MNE) carrying on a trade, profession or business in Hong Kong, will be subject to tax in Hong Kong. The proposed safe harbor rule allows MNEs to structure their disposal gains as onshore sourced and thereby not subject to the FSIE regime. Thereafter, so long as the conditions for the safe harbor rule are satisfied, i.e., the taxability of a gain is no longer subject to the uncertain "badges of trade" analysis, MNEs can enjoy certainty that gains will be accepted as non-taxable capital gains in Hong Kong. This proposed enhancement of tax certainty as regards disposal gains should contribute to Hong Kong's competitiveness as a location for holding equity investments.

Some apparent deviations from the safe harbor rule adopted in Singapore

The above proposed safe harbor rule appears to be modelled on that adopted by Singapore. However, the proposals contained in the Paper deviate in certain significant respects from the various provisions of section 13W of the Income Tax Act of Singapore that specify the conditions for Singapore's safe harbor rule. The deviations include:

(1) the Singapore legislation does not seem to contain an explicit provision regarding exception (iii)(b) above, i.e., disposal gains on non-listed equity interests in an immovable property-rich company are not automatically excluded from Singapore's safe harbor rule, regardless of whether the immovable properties are for self-use or not[1];

(2) the corresponding provision in Singapore that requires an investee company to not have undertaken any property development in the past 60 months is apparently to preserve the benefit of the previous less stringent safe harbor rule for development of a property in Singapore that was completed on or before 31 December 2022; and

(3) the ownership threshold of 20% for the safe harbor rule in Singapore is however higher than the threshold of 15% in Hong Kong.

Given the above, it seems that the government may need to further elaborate why the safe harbor rule proposed for Hong Kong must contain (a) exception (iii)(b) above; and (b) the 60-month period in exception (iii)(c) above, given that, unlike Singapore, Hong Kong is not constrained by a prior safe harbor rule.

1. The corresponding legislative provision in Singapore appears to be contained in subsection (8)(ba)(ii) of section 13W of the Income Tax Act. This subsection provides that the safe harbor rule in Singapore does not apply where the shares disposed of are not listed on a stock exchange in Singapore or elsewhere and the shares are in respect of a company that "principally carries on the activity of holding immovable properties situated whether in Singapore or elsewhere". The term "activity of holding immovable properties" employed in subsection (8)(ba)(ii) is further defined in subsection (9) of section 13W as excluding "the holding of immovable properties where such properties are used to carry on a trade or business, including the business of letting immovable properties". Therefore, reading subsection (8)(ba)(ii) and subsection (9) of section 13W together, the corresponding legislative provision in Singapore does not appear to exclude from its safe harbor rule gains on the disposal of an unlisted equity interest in an immovable property-rich company where the immovable properties are used by the company to carry on its own trade or business, including the business of letting immovable properties.

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

Wilson Cheng
Tax Leader for Hong Kong and Macau
+852 2846 9066
wilson.cheng@hk.ey.com

Business Tax Services / Global Compliance and Reporting

Hong Kong Tax Services

Wilson Cheng, +852 2846 9066, wilson.cheng@hk.ey.com
Tracy Ho, +852 2846 9065, tracy.ho@hk.ey.com
Jennifer Kam, +852 2846 9755, jennifer.kam@hk.ey.com
May Leung, +852 2629 3089, may.leung@hk.ey.com
Ada Ma, +852 2849 9391, ada.ma@hk.ey.com
Ricky Tam, +852 2629 3752, ricky.tam@hk.ey.com
Grace Tang, +852 2846 9889, grace.tang@hk.ey.com
Karina Wong, +852 2849 9175, karina.wong@hk.ey.com
Leo Wong, +852 2849 9165, leo.wong@hk.ey.com
Joy Chen (Family Office), +852 2846 9688, joy.chen@hk.ey.com

China Tax Services

Ivan Chan, +852 2629 3828, ivan.chan@hk.ey.com
Lorraine Cheung, +852 2849 9356, lorraine.cheung@hk.ey.com
Sam Fan, +852 2849 9278, sam.fan@hk.ey.com
Becky Lai, +852 2629 3188, becky.lai@hk.ey.com
Carol Liu, +852 2629 3788, carol.liu@hk.ey.com

Payroll Operate

Vincent Hu, +852 3752 4885, vincent-wh.hu@hk.ey.com

Accounting Compliance and Reporting

Linda Liu, +86 21 2228 2801, linda-sy.liu@cn.ey.com
Cecilia Feng, +852 2846 9735, cecilia.feng@hk.ey.com

International Tax and Transaction Services

International Tax Services

Jo An Yee, +852 2846 9710, jo-an.yee@hk.ey.com

Transfer Pricing Services

Sangeeth Aiyappa, +852 2629 3989, sangeeth.aiyappa@hk.ey.com
Martin Richter, +852 2629 3938, martin.richter@hk.ey.com
Kenny Wei, +852 2629 3941, kenny.wei@hk.ey.com

Transaction Tax Services

David Chan, +852 2629 3228, david.chan@hk.ey.com
Jane Hui, +852 2629 3836, jane.hui@hk.ey.com
Eric Lam, +852 2846 9946, eric-yh.lam@hk.ey.com
Qiannan Lu, +852 2675 2922, qiannan.lu@hk.ey.com

Financial Services

Paul Ho
Tax Leader for Hong Kong
+852 2849 9564
paul.ho@hk.ey.com

Business Tax Services / Global Compliance and Reporting

Hong Kong Tax Services

Paul Ho, +852 2849 9564, paul.ho@hk.ey.com
Ming Lam, +852 2849 9265, ming.lam@hk.ey.com
Sunny Liu, +852 2846 9883, sunny.liu@hk.ey.com
Helen Mok, +852 2849 9279, helen.mok@hk.ey.com

Customer Tax Operations and Reporting Services

Anish Benara, +852 2629 3293, anish.benara@hk.ey.com

US Tax Services

Camelia Ho, +852 2849 9150, camelia.ho@hk.ey.com
Michael Stenske, +852 2629 3058, michael.stenske@hk.ey.com

International Tax and Transaction Services

China Tax Services

Cindy Li, +852 2629 3608, cindy.jy.li@hk.ey.com

International Tax Services

Sophie Lindsay, +852 3189 4589, sophie.lindsay@hk.ey.com
Stuart Cioccarelli, +852 2675 2896, stuart.cioccarelli@hk.ey.com
Rohit Narula, +852 2629 3549, rohit.narula@hk.ey.com
Adam Williams, +852 2849 9589, adam-b.williams@hk.ey.com

Transfer Pricing Services

Ka Lok Chu, +852 2629 3044, kalok.chu@hk.ey.com
Justin Kyte, +852 2629 3880, justin.kyte@hk.ey.com

Transaction Tax Services

Rohit Narula, +852 2629 3549, rohit.narula@hk.ey.com

People Advisory Services

Robin Choi, +852 2629 3813, robin.choi@hk.ey.com
Mary Chua, +852 2849 9448, mary.chua@hk.ey.com
Christina Li, +852 2629 3664, christina.li@hk.ey.com
Jeff Tang, +852 2515 4168, jeff.tk.tang@hk.ey.com
Winnie Walker, +852 2629 3693, winnie.walker@hk.ey.com
Paul Wen, +852 2629 3876, paul.wen@hk.ey.com

Asia-Pacific Tax Centre

Tax Technology and Transformation Services

Agnes Fok, +852 2629 3709, agnes.fok@hk.ey.com
Robert Hardesty, +852 2629 3291, robert.hardesty@hk.ey.com
Albert Lee, +852 2629 3318, albert.lee@hk.ey.com

International Tax and Transaction Services

US Tax Desk

Jeremy Litton, +852 3471 2783, jeremy.litton@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

Alice Chung, +852 3758 5902, alice.chung@hk.ey.com
Edvard Rinck, +852 9736 3038, edvard.rinck@hk.ey.com

Indirect tax

Shubhendu Misra, +852 2232 6578, shubhendu.misra@hk.ey.com
Andy Winthrop, +852 2629 3556, andy.p.winthrop@hk.ey.com

Tax and Finance Operate

Tracey Kuuskoski, +852 2675 2842, tracey.kuuskoski@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. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit 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. 03017118
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

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