

## **LEGISLATIVE COUNCIL BRIEF**

Inland Revenue Ordinance  
(Chapter 112)

### **INLAND REVENUE (AMENDMENT) (DISPOSAL GAIN BY HOLDER OF QUALIFYING EQUITY INTERESTS) BILL 2023**

#### **INTRODUCTION**

A At the meeting of the Executive Council on 10 October 2023, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (Disposal Gain by Holder of Qualifying Interests) Bill 2023 (“Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”).

2. The Bill amends the Inland Revenue Ordinance (Cap. 112) (“IRO”) in order to introduce a tax certainty enhancement scheme (“the Scheme”) as announced in the 2023-24 Budget starting from the year of assessment 2023/24, so as to provide greater certainty of non-taxation of onshore gains on disposal of equity interests (“the Gains”) that are of capital nature.

#### **JUSTIFICATIONS**

##### **Facilitating business expansion and restructuring**

3. Hong Kong has a simple and competitive tax system which does not tax gains on disposal of equity interests that are of capital nature. To examine the nature of the Gains, the Inland Revenue Department (“IRD”) presently adopts a “badges of trade” approach, where considerations are given to the relevant facts and circumstances of the case, such as the frequency of similar trades, the holding

period, the shareholding percentage, reasons for purchase or sale of the equity interests, etc. If the Gains are determined to be capital in nature after the “badges of trade” analysis, they are not subject to profits tax; if they are determined to be revenue in nature, they are subject to profits tax. Similarly, onshore disposal losses that are of capital nature are not tax deductible but onshore disposal losses that are of revenue nature are deductible.

4. With the Foreign-sourced Income Exemption regime in place on 1 January 2023, offshore disposal gains of equity interest would only be tax-exempt if an investor has fulfilled the economic substance requirements or met the participation exemption criteria. Although such new requirements would mainly affect those investors who are in effect “shell companies” rather than normal businesses, certain investors may wish to mitigate any relevant tax risk by reducing their offshore transactions and having more onshore transactions in the future. Since acquisition and disposal of equity interests are common during the process of business expansion and restructuring, we foreshadowed last year that we would look into appropriate measures to enhance tax certainty for the Gains arising from such kind of transactions. The Financial Secretary subsequently announced in the 2023-24 Budget Speech that the Government will put forward an enhancement proposal to provide greater certainty of non-taxation of the Gains meeting specified criteria.

### **Guiding principles in formulating the Scheme**

5. In formulating the Scheme, we uphold the following principles to ensure the competitiveness of our tax system –

- (a) the Scheme will benefit a wide range of investors;
- (b) the Scheme will cover different forms of equity interests;
- (c) the Scheme will not undermine the simplicity of our tax system; and
- (d) the Scheme will minimise the risk of abuse to safeguard our tax revenue.

### **Tax certainty enhancement scheme**

6. Having considered the comments received during the consultation with the trade and the LegCo Panel on Financial Affairs, we propose that the Scheme

be implemented based on the features set out in paragraphs 7 to 9 below, as incorporated in the Bill.

*(A) Eligibility criteria*

7. Subject to exclusions under the Scheme, any gain, arising in or derived from Hong Kong<sup>1</sup>, that an investor entity obtains on the disposal of its equity interest in an investee entity is treated as capital in nature and not chargeable to profits tax if the following eligibility criteria are met -

- (a) the investor entity must be a legal person (not including a natural person)<sup>2</sup> or an arrangement that prepares separate financial accounts, such as a partnership and a trust. There is no resident or listing requirement on the investor entity. This allows the Scheme to benefit a wide range of businesses that may use different vehicles for the purpose of investment holding;
- (b) the subject matter disposed of must be an equity interest in an investee entity<sup>3</sup> which is defined to mean an interest that carries rights to the profits, capital or reserves of the investee entity and is accounted for as equity in the books of the investee entity under applicable accounting principles. Hence, the Scheme may apply to gains arising from disposal of different forms of equity interests, such as ordinary shares, preference shares<sup>4</sup>, and partnership interest;
- (c) the investor entity must meet the requirements on holding percentage and holding period, which are two factors crucial to the determination of whether the Gain is capital in nature. Specifically, the investor entity must have held certain equity interests in the investee entity throughout

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<sup>1</sup> For avoidance of doubt, the Gain does not cover any specified foreign-sourced income as defined by section 15H of the IRO, even if the specified foreign-sourced income is regarded under section 15I(1) of the IRO as a receipt arising in or derived from Hong Kong.

<sup>2</sup> As acquisition and disposal of equity interests are common during the process of business expansion and restructuring, it is our policy objective to facilitate businesses in such process through the Scheme. Natural person investors are usually not involved in this process.

<sup>3</sup> Similar to an investor entity, an investee entity must be a legal person (other than a natural person); or an arrangement that prepares separate financial accounts.

<sup>4</sup> But if preference shares are regarded as financial liability in the books of the investee entity under applicable accounting principles, such shares would fall outside the scope of the Scheme.

the continuous period of 24 months immediately before the date of disposal of the subject interests (i.e. “reference period”) and those equity interests having been held throughout the reference period must amount to at least 15% of the total equity interests (i.e. “qualifying interests”) in the investee entity (the requirements are called equity holding conditions).

Taking into account the views of the trade, we have introduced flexibility to the equity holding conditions. Specifically, even if the investor entity alone does not hold the qualifying interests, the equity holding conditions will still be considered as being met if the equity interests having been held by the investor entity and its closely related<sup>5</sup> entity / entities throughout the reference period in aggregate constitute qualifying interests in the investee entity.

In cases in which an investor entity or a closely related entity of an investor entity has acquired equity interests in the same investee entity on different occasions and has disposed part of the equity interests, those equity interests being acquired first will be taken to be the equity interest being disposed first (in line with the common accounting principle, “first in first out”) when determining whether certain equity interests in the investee entity have been held throughout the reference period<sup>6</sup>; and

- (d) upon meeting the equity holding conditions, the investor entity can have gains arising from the disposal of the equity interests held by it, and constituting the qualifying interests, (*the investor entity’s long-held interests*) covered by the Scheme even though the investor entities’ long-held interests are disposed of in tranches. In other words, although the investor entity’s equity holding percentage will fall after the disposal of each tranche and may fall below 15%, a gain arising from a tranche of the

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<sup>5</sup> An entity is a closely related entity of another entity if one of them has control over the other or both of them are under the control of the same entity. An entity must have remained a closely related entity of the investor entity throughout the reference period for its equity interests to be aggregated.

<sup>6</sup> For example, entity A acquired 15% of equity interests in entity B on 1 January 2023, and another 15% of equity interests in entity B on 15 January 2023. On 1 January 2025, entity A disposed of 20% of equity interests in entity B. In line with the first in first out principle, amongst the disposed interests constituting 20% of equity interests in entity B, 15% would be regarded as the equity interests acquired on 1 January 2023, whilst 5% would be regarded as the equity interests acquired on 15 January 2023. Hence, 15% of equity interests in entity B have been held throughout the continuous period of 24 months immediately before the disposal on 1 January 2025 and would be eligible for the Scheme (subject to all other conditions under the Scheme being met).

investor entity's long-held interests will still be covered by the Scheme. This is in line with suggestions made by stakeholders for the Scheme to cover disposal in tranches of equity interests which, if disposed of altogether, would qualify for the Scheme. However, for tax administration and risk control purpose, the disposal of equity interests in tranches would be allowed only if it is conducted within 24 months from the disposal of the tranche for which the investor entity has last met the equity holding conditions.

*(B) Exclusions*

8. To strike a balance between facilitating businesses and upholding the integrity of our tax system, we propose excluding from the Scheme the Gains which are normally not considered as capital in nature and those arising in circumstances where the risk of abuse is relatively high. The exclusions, which have been formulated by taking into account overseas experience with a view to preventing tax abuse, are largely on par with the requirements for other tax jurisdictions. Notwithstanding such exclusions, the Gains of excluded investor entities or in relation to excluded interests would continue to be examined by the IRD using the "badges of trade" approach under the existing arrangements. Specifically, we propose incorporating into the Bill certain exclusions from the Scheme as explained below –

- (a) given that making investments for returns forms part of the core business activities of an insurer, the gains on disposal of equity interests by an entity carrying on business as an insurer are normally considered as revenue in nature (i.e. subject to tax) irrespective of the holding period and the shareholding percentage of the equity interests. Therefore, the Scheme will not apply to any equity interests disposed of by an investor entity which is an insurer<sup>7</sup>;
- (b) as the Scheme should not affect the existing taxation principle that trading gains are taxable, the Scheme will not apply to equity interests held by an investor entity that have previously been regarded as trading stock (i.e. the

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<sup>7</sup> An investor entity is an insurer if Subdivision 1 of Division 11 of Part 4 of the IRO applies to the ascertainment of the investor entity's assessable profits for the year of assessment. An insurer's subsidiary which is not an insurer on its own is not excluded.

subject matters being traded by the investor as part of his ordinary business) for tax purposes<sup>8</sup>. Having said that, if such equity interests –

- (i) have subsequently been appropriated for a non-trade purpose; and
- (ii) the amount that the equity interests appropriated would have realized if sold in the open market on the date of the appropriation is brought into account as a receipt in accordance with the IRO,

the equity interests concerned may be eligible for the Scheme subject to the equity holding conditions as set out in paragraph 7 above being met, with the 24-month holding period required counting from the date of the appropriation; and

- (c) to avoid the Scheme being abused by businesses holding immovable properties as trading stock to claim their trading gains as non-taxable under the Scheme by pre-arranging their immovable properties to be acquired or held through an intermediate/another entity and then disposing of the equity interest in that entity, the Scheme will not apply to non-listed equity interests in investee entities engaging in property-related businesses, regardless of whether the properties are situated in Hong Kong or elsewhere<sup>9</sup>. In addition, by reference to other jurisdictions with similar schemes, we would limit the exclusion to disposals in non-listed investee entities engaging in property-related businesses whereas disposals in listed investee entities engaging in such businesses would not be excluded under

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<sup>8</sup> Specifically equity interests (specified equity interests) held by an entity (holding entity) are regarded as trading stock for the purpose of profits tax –

- (a) if any profit, gain or loss in respect of the specified equity interests has been brought into account for computing the holding entity's assessable profits or losses for the basis period for a year of assessment under—
  - (i) an assessment made on the holding entity that has become final and conclusive under section 70 of the IRO; or
  - (ii) a computation of losses issued in respect of the holding entity; or
- (b) if -
  - (i) the specified interests and other equity interests were acquired by the holding entity on the same occasion; and
  - (ii) any profit, gain or loss in respect of any of the other equity interests has been brought into account for computing the holding entity's assessable profits or losses for the basis period for a year of assessment as referred to in paragraph (a).

<sup>9</sup> Excluding non-listed equity interests in entities engaging in local or non-local property-related businesses would help prevent the Scheme from being perceived as ring-fenced from the local property market of Hong Kong which may constitute a harmful tax practice under the international tax standard.

the Scheme because it is very unlikely for the abovementioned tax abuse arrangement to be conducted through a listed entity. Specifically, non-listed equity interests in an investee entity are excluded from the scope of the Scheme if the investee entity –

- (i) carries on a business of acquisition and sale of immovable properties situated in Hong Kong or elsewhere<sup>10</sup> (i.e. typical trading business of immovable properties);
- (ii) undertakes or has undertaken property development in Hong Kong or elsewhere (i.e. developing immovable properties for sale), except if the investee entity had developed the properties for its own use (hence not for sale) and had ceased its property development business for a considerable period of time. Specifically, by reference to comparable jurisdiction’s relevant provision, the Scheme will still be applicable if –
  - (A) the immovable properties held by the investee entity are used by the investee entity to carry on its own trade or business (including the business of letting immovable properties) but none is for sale; and
  - (B) the investee entity has not undertaken property development for at least a continuous period of 60 months before the specified disposal; or
- (iii) holds any immovable properties situated in Hong Kong or elsewhere, directly or indirectly, and the percentage of value of such immovable properties<sup>11</sup> out of the entity’s total assets exceeds 50%<sup>12</sup>. However,

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<sup>10</sup> Unless the acquisition and sale of immovable properties is incidental to the undertaking of any property development by the entity.

<sup>11</sup> Value of immovable properties held by the investee entity means the aggregate value of (i) immovable properties directly held by the investee entity and (ii) any direct or indirect beneficial interest or any direct or indirect voting rights of the investee entity in another entity to the extent to which the value is attributable to immovable properties held by the other entity.

<sup>12</sup> When stipulating the prescribed threshold of 50%, we have made reference to the level of property holding that a company is considered as “property-rich” and a transfer of its shares or comparable interests that is considered as a transfer of the underlying property under Article 13(4) of the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital.

if immovable properties are used by the entity that directly holds the immovable properties for carrying on its own trade or business (including its business of letting immovable properties) but are not for sale, the value of such immovable properties is to be carved out from the numerator in determining the relevant percentage. Such carve-out of self-used immovable properties addresses the suggestion by stakeholders.

(C) *Other Features of the Scheme*

9. Other features of the Scheme include –

- (a) effective date and tenure of the Scheme – the Scheme applies to the Gains where the disposal occurs on or after 1 January 2024 and the Gains accrue in the basis period for a year of assessment beginning on or after 1 April 2023. No expiry date is specified for the Scheme which will be conducive to the purpose of the Scheme to provide tax certainty;
- (b) simple election procedure – the Scheme applies to an investor entity if it elects in writing by providing the requisite information in its profits tax return for the year of assessment in which the disposal occurs;
- (c) no adverse impact for non-election – the Scheme is not intended to form a new set of comprehensive rules for determining the nature of a particular gain or loss. In other words, the Scheme only provides an alternative option for taxpayers, and the status quo will apply to the Gains not eligible for the Scheme, i.e. the IRD will continue to use the “badges of trade” approach as the IRD does at present to consider the tax treatment of the disposal gains; and
- (d) the Scheme will also not affect the existing tax rule under which the nature of onshore losses on disposal of equity interests is determined based on “badges of trade” analysis.

**Tax competitiveness**

10. As compared to similar schemes in other tax jurisdictions, the Scheme has the following comparative advantages –



- (a) a wider coverage – our scheme is applicable to investors in different forms of business set-up and covers disposal gains in respect of all types of equity interest whereas in other jurisdictions, both investors and investees must be incorporated companies and only disposal gains on ordinary shares are covered;
- (b) lower threshold – the minimum equity holding percentage of 15% under the Scheme is lower than that of 20% in comparable jurisdictions;
- (c) more flexible arrangements – our Scheme allows the minimum equity holding percentage of 15% to be met on a corporate group basis by aggregating the interest held by the investor entity and its closely related entity / entities and covers disposal of equity interest in tranches subject to a 24-month restriction; and
- (d) no expiry – our Scheme does not specify an expiry date whereas it is time-limited elsewhere.

### **Benefits for business expansion and restructuring**

11. The Scheme will help further enhance the attractiveness of Hong Kong as a premier international investment and business hub. Specifically, we envisage that the Scheme will substantially facilitate business expansion and restructuring in the following aspects –

- (a) the Scheme provides existing investors and potential investors with upfront certainty of non-taxation on onshore disposal gains of equity interest based on simple and clear rules explained in paragraphs 7 to 9 above, obviating the need for such gains to go through the prevailing “badges of trade” analysis;
- (b) tax determination will be speeded up, because the Scheme requires shorter processing time and less documentation as compared to the “badges of trade” analysis; and
- (c) tax risks and compliance cost of businesses will be reduced, thereby providing a more conducive business environment for investment and business activities.

## OTHER OPTIONS

12. The introduction of the Scheme cannot be implemented without legislative amendments to the IRO. There is no other option.

## THE BILL

13. The main provisions of the Bill are as follows –

- (a) **Clause 3** adds a new Part 6F to the IRO in which new section 40AX is included. The new section 40AX introduces the new Schedule 17K;
- (b) **Clause 4** adds the new Schedule 17K to the IRO, which provides for the tax treatment in relation to the Gains covered by the Scheme;
- (c) Sections 1, 2 and 3 of the new Schedule 17K contain the definitions (such as definitions of *entity*, *equity interest* and *closely related entity*) for interpreting the Schedule;
- (d) Section 4 of the new Schedule 17K applies the proposed tax treatment to equity interests disposed of on or after 1 January 2024;
- (e) Section 5 of the new Schedule 17K provides for the treatment of a gain on the disposal by an entity (*investor entity*) of equity interests in another entity (*investee entity*) as capital in nature and not chargeable to profits tax if the equity holding conditions are met, which conditions mean—
  - (i) the investor entity has held certain equity interests throughout the continuous period of 24 months immediately before that disposal; and
  - (ii) the equity interests having been held throughout that 24-month period entitle the investor entity to at least a 15% share in the profits, capital or reserves of the investee entity;
- (f) Alternatively, an investor entity may have the equity interests that it has held throughout the above 24-month period and those having been held by its closely related entities throughout the period counted in aggregate

towards meeting the equity holding conditions (Section 5(4) of the new Schedule 17K);

- (g) Section 6 of the new Schedule 17K caters for disposal in tranches. The provisions will apply where the investor entity has certain equity interests in an investee entity for which the equity holding conditions in subparagraph (e) above were met (*long-held interests*), but the investor entity disposed of only part of the long-held interests (*first tranche*) and, after the disposal, the equity holding conditions cease to be met for the remainder of the long-held interests. Under section 6 of the new Schedule 17K, the remainder of the long-held interests will still be treated as capital in nature if they are disposed of (in tranches or otherwise) within 24 months after the disposal of the first tranche; and
- (h) Sections 8, 9, 10 and 11 of the new Schedule 17K provide for the exclusions referred to in paragraph 8 above.

## LEGISLATIVE TIMETABLE

14. The legislative timetable is as follows –

Publication in the Gazette	20 October 2023
First Reading and commencement of Second Reading debate	1 November 2023
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

## IMPLICATIONS OF THE PROPOSAL

15. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the binding effect of the existing provisions of the IRO. The economic and financial implications of the proposal are at **Annex B**. There are no civil service, productivity, environmental, family or gender implications, and no sustainability implications other than those set out in the economic implications paragraph.

## **PUBLIC CONSULTATION**

16. We conducted a trade consultation with more than 80 organisations from 23 March to 22 May 2023 on the proposed Scheme. During the consultation period, we organised three engagement sessions with key stakeholders. A total of 25 written submissions were received. The stakeholders generally welcomed the Scheme, and made different suggestions to refine the proposal. We also briefed the LegCo Panel on Financial Affairs on the proposed Scheme on 3 April 2023 and Panel members expressed general support for the proposal.

17. Having considered the merits and risks of abuse involved in the suggestions, we have taken on board many major suggestions, such as allowing aggregation of the equity interests held by closely related entities for meeting the 15% holding threshold, covering disposal of the equity interests concerned in tranches within a specified period under the Scheme, and not counting immovable properties that an investee entity directly holds for its own use of trade or business when determining whether the investee entity should be excluded from the Scheme.

## **PUBLICITY**

18. We will issue a press release on 18 October 2023. A spokesperson will be available to answer enquiries. To further promote the Scheme to investors, we will also arrange briefings for tax professionals, chambers of commerce and trade bodies.

## **ENQUIRIES**

19. Enquiries on this Brief can be directed to Mr Stephen LO, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2317.

**Financial Services and the Treasury Bureau  
October 2023**

**A BILL  
To**

Amend the Inland Revenue Ordinance to provide that a gain or profit derived from a disposal of equity interests, by an entity that has held a specified quantity of the equity interests throughout a specified period, is to be regarded as arising from the sale of capital assets and is not chargeable to profits tax; and to provide for related matters.

Enacted by the Legislative Council.

- 1. **Short title**  
This Ordinance may be cited as the Inland Revenue (Amendment) (Disposal Gain by Holder of Qualifying Equity Interests) Ordinance 2023.
- 2. **Inland Revenue Ordinance amended**  
The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 and 4.
- 3. **Part 6F added**  
After Part 6E—  
**Add**

**“Part 6F  
Disposal Gain by Holder of Qualifying Equity  
Interests**

**40AX. Schedule 17K: disposal gain by holder of qualifying equity interests**

Schedule 17K contains provisions for a gain or profit that an entity derives from a disposal of equity interests in another entity to be regarded, in circumstances specified in that Schedule, as arising from the sale of capital assets.”.

- 4. **Schedule 17K added**  
After Schedule 17J—  
**Add**

**“Schedule 17K**

[s. 40AX]

**Disposal Gain by Holder of Qualifying Equity  
Interests**

**Part 1**

**Preliminary**

- 1. **Interpretation**  
(1) In this Schedule—

**closely related entity** (密切相關實體)—see section 2 of this Schedule;

**construction** (建造)—

(a) means—

- (i) any building operation, or demolition and rebuilding operation, in, on, over or under any land for the purpose of erecting a building or part of a building; or
- (ii) any alteration or addition to, or partial demolition and rebuilding of, a building or part of a building,

that requires the consent of the Building Authority under section 14(1) of the Buildings Ordinance (Cap. 123) or, if carried out in a territory outside Hong Kong, of a similar supervisory authority of that territory; but

- (b) does not include works for the renovation or refurbishment, of a building or part of a building, with a view to maintaining the commercial value of the building or part;

**disposal** (處置), in relation to equity interests, means a transfer of the interests (other than a transfer effected by extinguishing the interests) for valuable consideration;

**entity** (實體) means—

- (a) a legal person (other than a natural person); or
- (b) an arrangement that prepares separate financial accounts, such as a partnership and a trust;

**equity holding conditions** (股權持有條件) means the equity holding conditions referred to in section 5(2) of this Schedule;

**equity interest** (股權權益)—see subsection (2);

**immovable property** (不動產)—

(a) means—

- (i) land (whether covered by water or not);
- (ii) any estate, right, interest or easement in or over any land; and
- (iii) things attached to land or permanently fastened to anything attached to land; but

(b) does not include infrastructure;

**infrastructure** (基礎設施) means any publicly or privately owned facility providing or distributing services for the benefit of the public, and includes any water, sewage, energy, fuel, transportation or communication facility;

**investee entity** (獲投資實體)—see section 5(1) of this Schedule;

**investee entity's relevant basis period** (獲投資實體的有關評稅基期), in relation to a disposal of equity interests in an investee entity, means the basis period of the investee entity for the year of assessment in which the disposal occurs;

**investor entity** (投資者實體)—see section 5(1) of this Schedule;

**property development** (物業發展) means construction or causing the construction of any building or part of a building, and includes acquisition of any land or building or part of a building for such construction and sale of any building or part of a building after such construction;

**property trading** (物業交易)—see subsection (4);

**qualifying interests** (合資格權益)—see subsection (3);

*reference period* (參考期間), in relation to a disposal of equity interests, means the continuous period of 24 months immediately before the date of the disposal.

- (2) In this Schedule, a reference to an equity interest in an entity is a reference to an interest that carries rights to the profits, capital or reserves of the entity where the interest is accounted for as equity, in the books of the entity, under applicable accounting principles.
- (3) In this Schedule, equity interests in an investee entity constitute qualifying interests in the investee entity if the interests, in aggregate, entitle the holder of the interests to at least a 15% share in the profits, capital or reserves of the investee entity.
- (4) For the purposes of this Schedule, an entity carries on a business of property trading if it carries on a business of acquisition and sale of immovable properties, situated in Hong Kong or elsewhere, unless the acquisition and sale of immovable properties is incidental to the undertaking of any property development by the entity.

**2. Meaning of closely related entity**

- (1) For the purposes of this Schedule, an entity is a closely related entity of another entity if—
  - (a) one of them has control over the other; or
  - (b) both of them are under the control of the same entity.
- (2) For the purposes of subsection (1), an entity (*entity A*) has control over another entity (*entity B*) if—
  - (a) entity A has more than 50% of direct or indirect beneficial interest in, or in relation to, entity B; or

- (b) entity A is directly or indirectly entitled to exercise, or control the exercise of, more than 50% of voting rights in, or in relation to, entity B.

**3. Meaning and extent of direct and indirect beneficial interest and voting rights**

- (1) In applying section 2(2) of this Schedule, if an entity (*entity A*) has a direct beneficial interest in another entity (*entity B*), the extent of the beneficial interest of entity A in entity B is—
  - (a) if entity B is a corporation that is not a trustee of a trust estate—the percentage of the issued share capital (however described) of the corporation held by entity A;
  - (b) if entity B is a partnership that is not a trustee of a trust estate—the percentage of the income of the partnership to which entity A is entitled;
  - (c) if entity B is a trustee of a trust estate—the percentage in value of the trust estate in which entity A is interested; or
  - (d) if entity B is an entity that does not fall within any of paragraphs (a), (b) and (c)—the percentage of entity A's ownership interest in the entity.
- (2) In applying section 2(2) of this Schedule, if entity A has an indirect beneficial interest in, or is indirectly entitled to exercise or control the exercise of voting rights in, entity B through another entity (*interposed entity*), the extent of the beneficial interest or voting rights of entity A in entity B is—
  - (a) if there is only one interposed entity—the percentage arrived at by multiplying the percentage

- representing the extent of the beneficial interest or voting rights of entity A in the interposed entity by the percentage representing the extent of the beneficial interest or voting rights of the interposed entity in entity B; or
- (b) if there is a series of 2 or more interposed entities—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest or voting rights of entity A in the first interposed entity in the series by—
- (i) the percentage representing the extent of the beneficial interest or voting rights of each interposed entity (other than the last interposed entity) in the series in the next interposed entity in the series; and
  - (ii) the percentage representing the extent of the beneficial interest or voting rights of the last interposed entity in the series in entity B.
- (3) For the purposes of subsection (2)—
- (a) subsection (1) applies in determining the extent of the beneficial interest of entity A in an interposed entity as if the references to entity B in subsection (1) were references to an interposed entity;
  - (b) subsection (1) applies in determining the extent of the beneficial interest of an interposed entity in entity B as if the references to entity A in subsection (1) were references to an interposed entity; and
  - (c) subsection (1) applies in determining the extent of the beneficial interest of an interposed entity (*interposed entity X*) in another interposed entity (*interposed entity Y*) as if—

- (i) the references to entity A in subsection (1) were references to interposed entity X; and
  - (ii) the references to entity B in subsection (1) were references to interposed entity Y.
- (4) In applying section 2(2)(b) of this Schedule, the voting rights attributed to entity A include all the voting rights of persons other than entity A so far as they are required, or may be required, to be exercised in one or more of the following ways—
- (a) on behalf of entity A;
  - (b) under the direction of entity A;
  - (c) for the benefit of entity A.
- (5) For the purposes of this section and section 2(2)(b) of this Schedule, if—
- (a) a reference is made to the exercise of the voting rights in an entity; and
  - (b) the entity is a corporation,
- the reference is to be read as a reference to the exercise of the voting rights at general meetings of the entity.

#### 4. Application of Schedule 17K

This Schedule applies to a gain or profit derived from a disposal of equity interests if—

- (a) the disposal occurs on or after 1 January 2024; and
- (b) the gain or profit accrues in the basis period for a year of assessment beginning on or after 1 April 2023.



## Part 2

### Basic Provisions

#### 5. Gain on disposal of equity interests regarded as capital in nature if equity holding conditions met

- (1) Subject to subsections (2) and (5) and sections 7, 8, 9 and 10 of this Schedule, any gain or profit (*disposal gain*), arising in or derived from Hong Kong, that an entity (*investor entity*) derives from a disposal (*subject disposal*) of equity interests (*subject interests*) in another entity (*investee entity*)—
  - (a) is to be regarded as arising from the sale of capital assets; and
  - (b) is not chargeable to profits tax under section 14.
- (2) Subject to section 6 of this Schedule, subsection (1) does not apply to the subject disposal of the subject interests unless the equity holding conditions are met for the subject disposal of the subject interests in the manner specified in subsection (3) or (4).
- (3) The equity holding conditions are met for the subject disposal of the subject interests if—
  - (a) the investor entity has held the subject interests throughout the reference period in relation to the subject disposal of the subject interests; and
  - (b) the subject interests by themselves, or together with certain other equity interests in the investee entity also having been held by the investor entity throughout the reference period, constitute qualifying interests in the investee entity.

- (4) Alternatively, the equity holding conditions are met for the subject disposal of the subject interests if—
    - (a) the investor entity has held the subject interests throughout the reference period in relation to the subject disposal of the subject interests, with or without also having held certain other equity interests in the investee entity throughout the reference period;
    - (b) one or more entities—
      - (i) each has been the investor entity's closely related entity throughout the reference period; and
      - (ii) each has held certain equity interests in the investee entity throughout the reference period; and
    - (c) the equity interests referred to in paragraphs (a) and (b), in aggregate, constitute qualifying interests in the investee entity.
  - (5) Subsection (1) does not apply to an investor entity unless it elects in writing that the subsection applies to it.
- #### 6. Exception to equity holding conditions: long-held left-overs from section 5(2) disposal
- (1) Even if the equity holding conditions are not met for a subject disposal by an investor entity of subject interests in an investee entity referred to in section 5(1) of this Schedule, section 5(2) of this Schedule does not prevent section 5(1) of this Schedule from applying to the subject disposal of the subject interests if—

- (a) the subject disposal of the subject interests is a disposal of long-held left-overs from a section 5(2) disposal, that is to say—
- (i) before the subject disposal of the subject interests, other equity interests in the investee entity (*earlier disposed interests*) were disposed of by the investor entity (*earlier disposal*);
  - (ii) the earlier disposal of the earlier disposed interests was a section 5(2) disposal; and
  - (iii) the equity holding conditions were met for the earlier disposal of the earlier disposed interests on the basis (among other things) that the subject interests—
    - (A) had been held by the investor entity throughout the reference period in relation to the earlier disposal of the earlier disposed interests; and
    - (B) constituted a part of the qualifying interests in the investee entity in relation to the earlier disposal of the earlier disposed interests; and
- (b) the subject disposal of the subject interests occurs within 24 months after the section 5(2) disposal.
- (2) In this section—
- section 5(2) disposal* (第 5(2)條處置) means a disposal of equity interests to which section 5(1) of this Schedule applies on the basis that the equity holding conditions are met for that disposal of those interests within the meaning of section 5(2) of this Schedule.

**7. Provisions supplementary to sections 5 and 6 of this Schedule**

- (1) Any specified foreign-sourced income (as defined by section 15H(1)) is not gain or profit arising in or derived from Hong Kong for the purposes of section 5(1) of this Schedule (even if the specified foreign-sourced income is regarded under section 15I(1) as a receipt arising in or derived from Hong Kong).
- (2) For the purposes of sections 5 and 6 of this Schedule, equity interests in an investee entity held by an investor entity or a closely related entity of an investor entity (*holding entity*) that—
  - (a) are of the same class and carry the same rights; but
  - (b) were acquired by the holding entity on different occasions,are taken to be disposed of by the holding entity in the order in which they were acquired (that is, on a first-in-first-out basis).
- (3) For the purposes of sections 5 and 6 of this Schedule, an investor entity or a closely related entity of an investor entity is treated as the holder of the equity interests in an investee entity during the borrowing period when the legal interest in the equity interests has been transferred by the investor entity or the closely related entity (as the case requires) to another entity under a stock borrowing and lending agreement.
- (4) In subsection (3)—  
*borrowing period* (借用期間) has the meaning given by section 15E(8);

*stock borrowing and lending agreement* (證券借用及借出協議) has the meaning given by section 19(16) of the Stamp Duty Ordinance (Cap. 117).

(5) For the purposes of the definitions of *borrowing period* and *stock borrowing and lending agreement* in subsection (4)—

(a) *recognized exchange company* (認可交易所) has the meaning given by section 2(1) of the Stamp Duty Ordinance (Cap. 117); and

(b) the following expressions have the meanings given by section 19(16) of the Stamp Duty Ordinance (Cap. 117)—

*borrowed stock* (被借用證券);

*borrower* (借用人);

*lender* (借出人);

*recognized clearing house* (認可結算所);

*rules* (規章);

*sale or purchase* (售賣或購買);

*stock borrowing* (證券借用);

*stock return* (證券交還); but

(c) a reference to Hong Kong stock in the definitions of *borrowed stock*, *borrower*, *lender* and *stock borrowing* referred to in paragraph (b) is to be construed as a reference to equity interest as defined by section 1(1) of this Schedule.

### Part 3

#### Equity Interests to which Section 5(1) of this Schedule does not Apply

##### 8. No application to equity interests disposed of by insurer

Section 5(1) of this Schedule does not apply to a disposal of any equity interests by an investor entity in the basis period for a year of assessment of the investor entity if Subdivision 1 of Division 11 of Part 4 applies to the ascertainment of the investor entity's assessable profits for the year of assessment.

##### 9. No application to equity interests regarded as trading stock

(1) Any equity interests (*firstly mentioned interests*) held by an entity that are regarded as trading stock for any period are to be disregarded for the purposes of sections 5 and 6 of this Schedule, to the extent of that period (*disregarded period*), and accordingly—

(a) no part of the disregarded period may be counted as a period during which the firstly mentioned interests are held by the entity for the purposes of sections 5 and 6 of this Schedule;

(b) section 5(1) of this Schedule does not apply to a disposal of the firstly mentioned interests if any part of the disregarded period coincides with any part of the reference period in relation to the disposal of the firstly mentioned interests; and

(c) the firstly mentioned interests must not be counted towards constituting the qualifying interests in the investee entity concerned in relation to a disposal of any equity interests by the entity (or by another

- entity of which the entity is a closely related entity) if any part of the disregarded period coincides with any part of the reference period in relation to the disposal of those equity interests.
- (2) For the purposes of this section, equity interests (*specified equity interests*) held by an entity (*holding entity*) are to be regarded as trading stock—
- (a) from the first day of the basis period for a year of assessment if any profit, gain or loss in respect of the specified equity interests has been brought into account for tax purposes for the year of assessment;
- (b) from the first day of the basis period for a year of assessment if—
- (i) the specified equity interests and other equity interests were acquired by the holding entity on the same occasion; and
- (ii) any profit, gain or loss in respect of any of the other equity interests (not arising from a disposal) has been brought into account for tax purposes for the year of assessment; or
- (c) from a day (*that day*) if—
- (i) the specified equity interests and other equity interests were acquired by the holding entity on the same occasion; and
- (ii) any profit, gain or loss arising from a disposal, on that day, of any of the other equity interests has been brought into account for tax purposes for a year of assessment.
- (3) Any equity interests regarded as trading stock under subsection (2) cease to be regarded as such if—

- (a) the equity interests are appropriated for a non-trade purpose; and
- (b) the holding entity has the amount that the appropriated equity interests would have realized, if sold in the open market on the date of the appropriation, brought into account as a receipt in accordance with section 15BA(2).
- (4) In this section, a reference to a period for which any equity interests are regarded as trading stock is a reference to a period—
- (a) beginning on the day from which the equity interests are regarded as trading stock under subsection (2); and
- (b) ending on the day on which the equity interests cease to be regarded as trading stock under subsection (3).
- (5) For the purposes of subsection (2), a sum has been brought into account for tax purposes for a year of assessment if the sum has been brought into account for computing the holding entity's assessable profits or losses for the basis period for the year of assessment under—
- (a) an assessment made on the holding entity that has become final and conclusive under section 70; or
- (b) a computation of losses issued in respect of the holding entity.
- 10. No application to non-listed equity interests in property-related entities**
- (1) Section 5(1) of this Schedule does not apply to a disposal of any equity interests in an investee entity (*specified disposal*) if—

- (a) the equity interests are not listed or traded on a stock exchange in Hong Kong or elsewhere at the time of the specified disposal; and
  - (b) the investee entity is an excluded entity under subsection (2), (3) or (5).
- (2) The investee entity is an excluded entity under this subsection if it carries on a business of property trading in the investee entity's relevant basis period.
- (3) Where the investee entity is not an excluded entity under subsection (2), the investee entity is an excluded entity under this subsection if it undertakes or has undertaken property development, in Hong Kong or elsewhere, in or before the investee entity's relevant basis period.
- (4) However, an investee entity does not become an excluded entity under subsection (3) if—
- (a) the investee entity has not undertaken property development, whether in Hong Kong or elsewhere, for at least a continuous period of 60 months before the specified disposal;
  - (b) in the investee entity's relevant basis period, the immovable properties held by the investee entity are used by it to carry on its trade or business, including used by it to carry on a business of letting immovable properties; and
  - (c) in the investee entity's relevant basis period, none of the immovable properties held by the investee entity is for sale.
- (5) Where—
- (a) the investee entity is not an excluded entity under subsection (2); and

- (b) the investee entity is not an excluded entity under subsection (3) and this is not because of the operation of subsection (4),

the investee entity is an excluded entity under this subsection if the investee entity holds any immovable properties, in Hong Kong or elsewhere, in the investee entity's relevant basis period, and the investee entity's immovable property holding (as calculated under section 11 of this Schedule) in that basis period exceeds 50%.

#### 11. Calculation of immovable property holding

- (1) For determining, in relation to a disposal of equity interests in an investee entity (*specified disposal*), whether the investee entity is an excluded entity under section 10(5) of this Schedule, the investee entity's immovable property holding in the investee entity's relevant basis period is to be calculated in accordance with the following formula—

$$\frac{A}{B} \times 100\%$$

where: A means the aggregate of the following—

- (a) the value of any specified immovable property of the investee entity;
- (b) the value of any direct or indirect beneficial interest, or any direct or indirect voting rights, of the investee entity in another entity to the extent to which the value is attributable to

any specified immovable property of the other entity;

B means the total value of the investee entity's assets.

- (2) For the purposes of subsection (1), the value of a direct or indirect beneficial interest, or direct or indirect voting rights, of the investee entity in another entity that is attributable to any specified immovable property of the other entity is the value arrived at by multiplying—
- (a) the percentage representing the extent of the direct or indirect beneficial interest, or direct or indirect voting rights, of the investee entity in the other entity; by
  - (b) the value of the specified immovable property.
- (3) For the purposes of this section, each of the following (each a *specified item's value*)—
- (a) the value of any specified immovable property of the investee entity or another entity;
  - (b) the value of any direct or indirect beneficial interest, or any direct or indirect voting rights, of the investee entity;
  - (c) the total value of the investee entity's assets,
- is to be calculated in accordance with the following formula—

$$\frac{C + D}{2}$$

where: C means the specified item's value as at the beginning of the investee entity's relevant basis period;

D means the specified item's value as at—

- (a) the end of the investee entity's relevant basis period; or
- (b) the time of the specified disposal.

- (4) In this section, a reference to any direct or indirect voting rights of an investee entity in another entity is a reference to any voting rights in the other entity that the investee entity is directly or indirectly entitled to exercise, or the exercise of which the investee entity is directly or indirectly entitled to control.
- (5) Section 3 of this Schedule applies for the purposes of this section as it applies for the purposes of section 2(2) of this Schedule.
- (6) In this section—
- specified immovable property* (指明不動產), in relation to an entity, means any immovable property, in Hong Kong or elsewhere, that is directly held by the entity, other than any immovable property used by the entity to carry on its trade or business.
- (7) In subsection (6), a reference to any immovable property being used by an entity to carry on its trade or business—
- (a) subject to paragraph (b), includes any immovable property being used by the entity to carry on a business of letting immovable properties; and
  - (b) excludes any immovable property for sale.

#### Part 4

##### Application of Section 5(1) of this Schedule: Mixture of Equity Interests

###### 12. Equity interests only partly eligible to be regarded as capital in nature

- (1) If equity interests in an investee entity, consisting partly of eligible interests and partly of ineligible interests, are disposed of by an investor entity on an occasion, section 5(1) of this Schedule applies to the disposal to the extent of the eligible interests.
- (2) In relation to a disposal of equity interests in an investee entity by an investor entity on an occasion—
  - (a) an equity interest so disposed of is an eligible interest if, had it been the only equity interest disposed of on the occasion, section 5(1) of this Schedule would have applied to the disposal; and
  - (b) an equity interest so disposed of is an ineligible interest if, had it been the only equity interest disposed of on the occasion, section 5(1) of this Schedule would not have applied to the disposal.”.

#### Explanatory Memorandum

The object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*Ordinance*) to provide that any gain or profit derived by an entity (*investor entity*) from a disposal (*subject disposal*) of equity interests (*subject interests*) in another entity (*investee entity*) is to be regarded as a gain on the sale of capital assets and is not chargeable to profits tax (*proposed tax treatment*) if the equity holding conditions (see paragraph 6) are met, unless an exception applies. This is to enhance the certainty of non-taxation when qualifying equity interests in businesses held for a specified period are disposed of.

2. Clauses 3 and 4 add to the Ordinance a new Part 6F (comprising only a new section 40AX) and a new Schedule 17K (which is introduced by the new section 40AX). The following paragraphs state, in gist, the effect of the main provisions of the new Schedule 17K.
3. The new Schedule 17K consists of 4 parts.
4. Part 1 of the new Schedule 17K (consisting of sections 1 to 4) contains preliminary provisions. In particular—
  - (a) section 1 of the new Schedule 17K contains the definitions (such as definitions of *entity*, *equity interest*, *property development* and *property trading*) for interpreting the Schedule;
  - (b) sections 2 and 3 of the new Schedule 17K define *closely related entity* and related expressions; and
  - (c) under section 4 of the new Schedule 17K, the proposed tax treatment applies to a disposal of equity interests that occurs on or after 1 January 2024.
5. Part 2 of the new Schedule 17K (consisting of sections 5 to 7) contains basic provisions on the proposed tax treatment.

6. Section 5(2) of the new Schedule 17K introduces the equity holding conditions that must be met in the manner specified in section 5(3) or (4) of that Schedule, before the proposed tax treatment (provided for under section 5(1) of that Schedule) applies to the subject disposal of the subject interests.
- (a) In essence, section 5(3) of the new Schedule 17K provides that—
- (i) the investor entity must have held certain equity interests in the investee entity (inclusive of the subject interests) throughout the period of 24 months immediately before the subject disposal of the subject interests; and
- (ii) the equity interests that the investor entity has held as mentioned in sub-subparagraph (i) must constitute qualifying interests in the investee entity, which means that those equity interests must entitle the investor entity to at least a 15% share in the profits, capital or reserves of the investee entity.
- (b) Alternatively, section 5(4) of the new Schedule 17K provides that the investor entity may have the following counted in aggregate towards constituting the qualifying interests referred to in subparagraph (a)(ii)—
- (i) the equity interests in the investee entity (inclusive of the subject interests) that the investor entity has held throughout the period of 24 months immediately before the subject disposal of the subject interests;
- (ii) if any equity interests in the investee entity have been held by any particular closely related entity of the investor entity throughout that same period—the

- aggregate of the equity interests having been so held by the closely related entities.
7. Section 6 of the new Schedule 17K caters for disposal in tranches. Suppose—
- (a) the equity holding conditions mentioned in paragraph 6(a) or (b) were met for a disposal of certain equity interests in an investee entity held by an investor entity (*long-held interests*); but
- (b) only part of the long-held interests (*first tranche*) were disposed of and the equity holding conditions are not met for the remaining long-held interests.
- Under section 6 of the new Schedule 17K, the proposed tax treatment will continue to apply to the remaining long-held interests if they are disposed of (in tranches or otherwise) within the next 24 months after the disposal of the first tranche.
8. Part 3 of the new Schedule 17K (consisting of sections 8 to 11) provides that the proposed tax treatment does not apply to—
- (a) a disposal of equity interests by an insurer;
- (b) a disposal of equity interests regarded as trading stock; or
- (c) a disposal of non-listed equity interests in an investee entity that carries on, or carried on, activities relating to immovable properties as specified in section 10(2), (3) or (5) of the new Schedule 17K.
9. Part 4 of the new Schedule 17K (consisting of section 12) provides that if a disposal of equity interests on an occasion covers not only equity interests to which the proposed tax treatment applies (*eligible interests*) but also other equity interests, the proposed tax treatment applies to the disposal to the extent of the eligible interests.



**Economic and Financial Implications of the Proposal**

***Economic Implications***

The Scheme will increase certainty for business operation and facilitate business expansion and restructuring through disposal of equity interests. It will hence increase the competitiveness of Hong Kong's tax regime and enhance the attractiveness of Hong Kong as a place for doing business.

***Financial Implications***

2. The Government revenue implications of the Scheme is expected to be minimal. In any event, the Scheme does not aim to alter the existing tax system which does not tax gains on disposal of equity interests of capital nature. Instead, it aims to provide greater certainty for the non-taxability of gains on disposal of equity interests which are of capital nature.