

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

Inland Revenue (Amendment) (Disposal Gain by Holder of Qualifying Equity Interests) Bill 2023

Explanatory Memorandum
Paragraph 9

C2801

- (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.